ANNALY CAPITAL MANAGEMENT INC
Form 10-K
February 28, 2012

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C.20549

FORM 10-K

(MARK ONE)

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED: DECEMBER 31, 2011

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER: 1-13447

ANNALY CAPITAL MANAGEMENT, INC.
(Exact Name of Registrant as Specified in its Charter)

MARYLAND	22-3479661
(State or other jurisdiction of incorporation of organization)	(I.R.S. Employer Identification Number)
1211 Avenue of the Americas, Suite 2902 New York, New York (Address of Principal Executive Offices)	10036 (Zip Code)

(212) 696-0100
(Registrant’s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value $.01 per share	New York Stock Exchange
7.875% Series A Cumulative Redeemable Preferred Stock	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None.

Indicate by check mark whether the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes X No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No X

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes X_ No___

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days:

Yes X_ No ___

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer or a smaller reporting company. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer X Accelerated filer __ Non-accelerated filer __ Smaller reporting company___

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes __ No _X_.

At June 30, 2011, the aggregate market value of the voting stock held by non-affiliates of the Registrant was $14,913,563,080.

The number of shares of the Registrant's Common Stock outstanding on February 24, 2012 was 970,269,506.

Documents Incorporated by Reference

The registrant intends to file a definitive proxy statement pursuant to Regulation 14A within 120 days of the end of the fiscal year ended December 31, 2011. Portions of such proxy statement are incorporated by reference into Part III of this Form 10-K.

ANNALY CAPITAL MANAGEMENT, INC.
2011 FORM 10-K ANNUAL REPORT
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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain statements contained in this annual report may not be based on historical facts and are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements, which are based on various assumptions (some of which are beyond our control), may be identified by reference to a future period or periods or by the use of forward-looking terminology, such as "may," "will," "believe," "expect," "anticipate," "continue," or similar terms or variations on those terms or the negative of those terms. Actual results could differ materially from those set forth in forward-looking statements due to a variety of factors, including, but not limited to:

changes in interest rates,

changes in the yield curve,

changes in prepayment rates,

the availability of mortgage-backed securities and other securities for purchase,

the availability of financing and, if available, the terms of any financing,

changes in the market value of our assets,

changes in business conditions and the general economy,

our ability to consummate any contemplated investment opportunities,

risks associated with the investment advisory business of our wholly owned subsidiaries, including:

- the removal by clients of assets managed,
- their regulatory requirements, and
- competition in the investment advisory business,

risks associated with the broker-dealer business of our subsidiary,

changes in government regulations affecting our business,

our ability to maintain our exemption from registration under the Investment Company Act of 1940, and

our ability to maintain our qualification as a REIT for federal income tax purposes.

No forward-looking statements can be guaranteed and actual future results may vary materially and we caution you not to place undue reliance on these forward-looking statements. For a discussion of the risks and uncertainties which could cause actual results to differ from those contained in the forward-looking statements, please see the information under the caption "Risk Factors" described in this Form 10-K.We do not undertake, and specifically disclaim any obligation, to publicly release the result of any revisions which may be made to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements except as required by law.

PART I

ITEM 1. BUSINESS

All references to "we," "us," or "our" mean Annaly Capital Management, Inc. and all entities owned by us, except where it is made clear that the term means only the parent company. The following defines certain of the commonly used terms in this annual report on Form 10-K: Agency refers to a federally chartered corporation, such as Fannie Mae or Freddie Mac, or an agency of the U.S. Government, such as Ginnie Mae; Agency mortgage-backed securities refers to residential mortgage-backed securities that are issued or guaranteed by an Agency; Investment Securities refers to Agency mortgage-backed securities, Agency debentures, corporate debt securities and reverse repurchase agreement loans; and Interest Earning Assets refers to Investment Securities, securities borrowed and U.S. Treasury Securities.

THE COMPANY

Background

We own, manage, and finance a portfolio of real estate related investments, including mortgage pass-through certificates, collateralized mortgage obligations (or CMOs), Agency callable debentures, and other securities representing interests in or obligations backed by pools of mortgage loans. Our principal business objective is to generate net income for distribution to our stockholders from the spread between the interest income on our Interest Earning Assets and the cost of borrowings to finance our acquisition of Interest Earning Assets and from dividends we receive from our subsidiaries. Our wholly-owned subsidiaries offer diversified real estate, asset management and other financial services.

We are a Maryland corporation that commenced operations on February 18, 1997. We are self-advised and self-managed. We acquired Fixed Income Discount Advisory Company (or FIDAC) on June 4, 2004 and Merganser Capital Management, Inc. (or Merganser) on October 31, 2008. FIDAC and Merganser manage a number of investment vehicles and separate accounts for which they earn fee income. Our subsidiary, RCap Securities, Inc. (or RCap), operates as a broker-dealer, and was granted membership in the Financial Industry Regulatory Authority (or FINRA) in January 2009. In 2010, we established Shannon Funding LLC (or Shannon), which provides warehouse financing to residential mortgage originators in the United States. In 2010, we also established Charlesfort Capital Management LLC (or Charlesfort), which engages in corporate middle market lending transactions. In 2011, FIDAC established FIDAC Europe Limited (or FIDAC Europe), which provides advice on commercial real estate transactions, including sale-leaseback and single tenant net leased properties across Europe. In 2011, we established FIDAC FSI LLC (or FIDAC FSI), which invests in trading securities. We also own an additional subsidiary which owns trading securities.

We have elected and believe that we are organized and have operated in a manner that qualifies us to be taxed as a real estate investment trust (or REIT) under the Internal Revenue Code of 1986, as amended (or the Code). If we qualify for taxation as a REIT, we generally will not be subject to federal income tax on our taxable income that is distributed to our stockholders. Therefore, substantially all of our assets, other than FIDAC, Merganser and RCap, which are our taxable REIT subsidiaries, consist of qualified REIT real estate assets (of the type described in Section 856(c)(5)(B) of the Code). We have financed our purchases of Agency mortgage-backed securities and Agency debentures with the net proceeds of equity offerings and borrowings under repurchase agreements whose interest rates adjust based on changes in short-term market interest rates.

Capital Investment Policy

Under our capital investment policy, at least 75% of our total assets must be comprised of high-quality mortgage-backed securities and short-term investments. High quality securities means securities that (1) are rated within one of the two highest rating categories by at least one of the nationally recognized rating agencies, (2) are unrated but are guaranteed by the United States government or an agency of the United States government, or (3) are unrated but we determine them to be of comparable quality to rated high-quality mortgage-backed securities.

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The remainder of our assets, comprising not more than 25% of our total assets, may consist of other qualified REIT real estate assets which are unrated or rated less than high quality, but which are at least "investment grade" (rated "BBB" or better by Standard & Poor's Corporation (or S&P) or the equivalent by another nationally recognized rating agency) or, if not rated, we determine them to be of comparable credit quality to an investment which is rated "BBB" or better. In addition, we may directly or indirectly invest part of this remaining 25% of our assets in other types of securities, including but without limitation, unrated debt, equity or derivative securities, to the extent consistent with our REIT qualification requirements. The derivative securities in which we invest may include securities representing the right to receive interest only or a disproportionately large amount of interest, as well as inverse floaters, which may have imbedded leverage as part of their structural characteristics. We intend to structure our portfolio to maintain a minimum weighted average rating (including our deemed comparable ratings for unrated mortgage-backed securities) of our mortgage-backed securities of at least single "A" under the S&P rating system and at the comparable level under the other rating systems.

We may acquire mortgage-backed securities backed by single-family residential mortgage loans as well as securities backed by loans on multi-family, commercial or other real estate related properties. To date, substantially all of the mortgage-backed securities that we have acquired have been backed by single-family residential mortgage loans.

To date, substantially all of the mortgage-backed securities that we have acquired have been Agency mortgage-backed securities which, although not rated, carry an implied "AAA" rating. Agency mortgage-backed securities consist of agency pass-through certificates and CMOs issued or guaranteed by an Agency. Pass-through certificates provide for a pass-through of the monthly interest and principal payments made by the borrowers on the underlying mortgage loans. CMOs divide a pool of mortgage loans into multiple tranches with different principal and interest payment characteristics.

Our adjustable-rate pass-through certificates are backed by adjustable-rate mortgage loans and have coupon rates which adjust over time, subject to interest rate caps and lag periods, in conjunction with changes in short-term interest rates. Our fixed-rate pass-through certificates are backed by fixed-rate mortgage loans and have coupon rates which do not adjust over time. CMO floaters are tranches of mortgage-backed securities where the interest rate adjusts in conjunction with changes in short-term interest rates. CMO floaters may be backed by fixed-rate mortgage loans or, less often, by adjustable-rate mortgage loans. In this Form 10-K, except where the context indicates otherwise, we use the term "adjustable-rate interest-earning assets" to refer to adjustable-rate pass-through certificates, CMO floaters, Agency debentures and corporate debt.

We may also invest in Agency debentures, which consist of debentures issued by the Federal Home Loan Bank (FHLB), Freddie Mac and Fannie Mae. We intend to continue to invest in adjustable-rate pass-through certificates, fixed-rate mortgage-backed securities, CMO floaters, and Agency debentures. We may also invest on a limited basis in derivative securities which include securities representing the right to receive interest only or a disproportionately large amount of interest as well as inverse floaters, which may have imbedded leverage as part of their structural characteristics. We have not and will not invest in real estate mortgage investment conduit (REMIC) residuals and other CMO residuals.

Borrowings

We attempt to structure our collateralized borrowings to have interest rate adjustment indices and interest rate adjustment periods that, on an aggregate basis, correspond generally to the interest rate adjustment indices and periods of our adjustable-rate interest-earning assets. However, periodic rate adjustments on our collateralized borrowings are generally more frequent than rate adjustments on our Investment Securities.

We generally expect to maintain a ratio of debt-to-equity of between 8:1 and 12:1, although the ratio may vary, as it currently does because of market conditions, from this range from time to time based upon various factors, including our management's opinion of the level of risk of our assets and liabilities, our liquidity position, our level of unused borrowing capacity and over-collateralization levels required by lenders when we pledge assets to secure borrowings. For purposes of calculating this ratio, our equity is equal to the value of our investment portfolio on a mark-to-market basis, less the book value of our obligations under repurchase agreements and other collateralized borrowings and convertible senior notes. At December 31, 2011, our ratio of debt-to-equity was 5.4:1.

During 2010, we issued $600.0 million in aggregate principal amount of our 4% convertible senior notes due 2015 (Convertible Senior Notes) for net proceeds following underwriting expenses of approximately $582.0 million. Interest on the notes is paid semi-annually at a rate of 4% per year and the notes will mature on February 15, 2015 unless earlier repurchased or converted. As of December 31, 2011 the notes were convertible into shares of common stock at a conversion rate of 62.2331 shares of common stock per $1,000 principal amount of notes, which is equivalent to a conversion price of approximately $16.0686 per share of common stock, subject to adjustment in certain circumstances.

Hedging

To the extent consistent with our election to qualify as a REIT, we enter into hedging transactions to attempt to protect our Agency mortgage-backed securities and Agency debentures and related borrowings against the effects of major interest rate changes. This hedging is used to mitigate declines in the market value of our Agency mortgage-backed securities and Agency debentures during periods of increasing interest rates and to limit or cap the interest rates on our borrowings. These transactions are entered into solely for the purpose of hedging interest rate or prepayment risk and not for speculative purposes. In connection with our interest rate risk management strategy, we hedge a portion of our interest rate risk by entering into derivative financial instrument contracts.

Our Subsidiaries

FIDAC, an investment advisor registered with the SEC, is a fixed-income investment management company specializing in managing fixed income investments in residential mortgage-backed securities, commercial mortgage-backed securities and collateralized debt obligations for various investment vehicles and separate accounts. FIDAC also has experience in managing and structuring debt financing associated with various asset classes and as a liquidation agent of collateralized debt obligations. FIDAC commenced active investment management operations in 1994. At December 31, 2011, FIDAC was the adviser or sub-adviser for REITs and other investment vehicles. The team managing Annaly perform the same roles at FIDAC.

Merganser, an investment advisor registered with the SEC, has expertise in a variety of fixed income strategies and focuses on managing each portfolio based on each client's specific investment principles. Merganser serves a diverse group of clients in a variety of disciplines nationwide including pension, public, operating, Taft-Hartley and endowment funds as well as defined contribution plans. Merganser's investment team maintains a careful balance of risk management and performance by employing fundamental security analysis and by trading in an environment supported by state-of-the-art technology, infrastructure and operations.

RCap operates as a broker-dealer and has been a member in the Financial Industry Regulatory Authority (or FINRA) since January 2009.

In 2010, we established Shannon, which provides warehouse financing to residential mortgage originators in the United States. In 2010, we also established Charlesfort, which engages in corporate middle market lending transactions. In 2011, FIDAC established FIDAC Europe Limited, which provides advice on commercial real estate transactions, including sale-leaseback and single tenant net leased properties across Europe. In 2011, we established FIDAC FSI LLC, which invests in trading securities. We also own an additional subsidiary which owns trading securities.

Compliance with REIT and Investment Company Requirements

We constantly monitor our investments and the income from these investments and, to the extent we enter into hedging transactions, we monitor income from our hedging transactions as well, so as to ensure at all times that we

maintain our qualification as a REIT and our exemption from registration under the Investment Company Act of 1940, as amended.

Executive Officers of the Company

The following table sets forth certain information as of February 25, 2012 concerning our executive officers:

Name	Age	Position held with the Company
Michael A.J. Farrell	60	Chairman of the Board, Chief Executive Officer and President
Wellington J. Denahan-Norris	48	Vice Chairman of the Board, Chief Investment Officer and Chief Operating Officer
Kathryn F. Fagan	45	Chief Financial Officer and Treasurer
R. Nicholas Singh	52	Chief Legal Officer, Secretary and Chief Compliance Officer
James P. Fortescue	38	Managing Director, Head of Liabilities and Chief of Staff
Kristopher Konrad	37	Managing Director and Head Portfolio Manager
Rose-Marie Lyght	38	Managing Director and Chief Investment Officer of FIDAC
Jeremy Diamond	48	Managing Director and Head of Research and Corporate Communications
Ronald Kazel	44	Managing Director and Head of Asset Management Group
Matthew Lambiase	45	Managing Director and Head of Business Development
Kevin Keyes	44	Managing Director and Chief Strategy Officer

Mr. Farrell and Ms. Denahan-Norris have had years of experience in the investment banking and investment management industries where, in various capacities, they have each managed portfolios of mortgage-backed securities, arranged collateralized borrowings and utilized hedging techniques to mitigate interest rate and other risk within fixed-income portfolios. Ms. Fagan is a certified public accountant and, prior to becoming our Chief Financial Officer and Treasurer, served as Chief Financial Officer and Controller of a publicly owned savings and loan association. Mr. Singh joined Annaly in 2005. Mr. Fortescue joined Annaly in 1997. Mr. Konrad joined Annaly in 1997. Ms. Lyght joined Annaly in 1999. Mr. Diamond joined Annaly in 2002. Mr. Kazel joined Annaly in 2001. Mr. Lambiase joined Annaly in 2004. Mr. Keyes joined Annaly in September 2009.

Distributions

To maintain our qualification as a REIT, we must distribute substantially all of our taxable income to our stockholders each year (subject to certain adjustments). We have done this in the past and intend to continue to do so in the future. We also have declared and paid regular quarterly dividends in the past and intend to do so in the future. We have adopted a dividend reinvestment plan to enable holders of common stock to reinvest dividends automatically in additional shares of common stock.

BUSINESS STRATEGY

General

Our principal business objective is to generate income for distribution to our stockholders, primarily from the net cash flows on our Investment Securities. Our net cash flows result primarily from the difference between the interest income on our Investment Securities and borrowing costs of our repurchase agreements, and from dividends we receive from our subsidiaries. To achieve our business objective and generate dividend yields, our strategy is:

- to acquire Investment Securities that we believe:
  - we have the necessary expertise to evaluate and manage;
  - we can readily finance;
  - are consistent with our balance sheet guidelines and risk management objectives; and
  - provide attractive investment returns in a range of scenarios;
- to finance purchases of mortgage-backed securities with the proceeds of equity and debt offerings and, to the extent permitted by our capital investment policy, to utilize leverage to increase potential returns to stockholders through borrowings;
- to attempt to structure our borrowings to have interest rate adjustment indices and interest rate adjustment periods that, on an aggregate basis, generally correspond to the interest rate adjustment indices and interest rate adjustment periods of our adjustable-rate mortgage-backed securities;
- to seek to minimize prepayment risk by structuring a diversified portfolio with a variety of prepayment characteristics and through other means; and
- to issue new equity or debt and increase the size of our balance sheet when opportunities in the market for mortgage-backed securities are likely to allow growth in earnings per share.

We believe we are able to obtain cost efficiencies through our facilities-sharing arrangement with FIDAC and RCap and by virtue of our management's experience in managing portfolios of mortgage-backed securities and arranging collateralized borrowings. We will strive to become even more cost-efficient over time by:

- seeking to raise additional capital from time to time in order to increase our ability to invest in mortgage-backed securities;
- striving to lower our effective borrowing costs by seeking direct funding with collateralized lenders, rather than using financial intermediaries, and investigating the possibility of using commercial paper and medium term note programs;
- improving the efficiency of our balance sheet structure by investigating the issuance of uncollateralized subordinated debt, preferred stock and other forms of capital; and
- utilizing information technology in our business, including improving our ability to monitor the performance of our Investment Securities and to lower our operating costs.

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Mortgage-Backed Securities

General

To date, substantially all of the mortgage-backed securities that we have acquired have been Agency mortgage-backed securities which, although not rated, carry an implied "AAA" rating. Agency mortgage-backed securities are mortgage-backed securities where a government agency or federally chartered corporation, such as Freddie Mac, Fannie Mae or Ginnie Mae, guarantees payments of principal or interest on the securities. Agency mortgage-backed securities consist of agency pass-through certificates and CMOs issued or guaranteed by an agency.

We intend to acquire only those mortgage-backed securities that we believe we have the necessary expertise to evaluate and manage, that are consistent with our balance sheet guidelines and risk management objectives and that we believe we can readily finance. Since we generally hold the mortgage-backed securities we acquire until maturity, we generally do not seek to acquire assets whose investment returns are attractive in only a limited range of scenarios. We believe that future interest rates and mortgage prepayment rates are very difficult to predict. Therefore, we seek to acquire mortgage-backed securities which we believe will provide acceptable returns over a broad range of interest rate and prepayment scenarios.

At December 31, 2011, our mortgage-backed securities consisted of pass-through certificates and CMOs issued or guaranteed by Freddie Mac, Fannie Mae or Ginnie Mae. We have not, and will not, invest in REMIC residuals and other CMO residuals.

Description of Mortgage-Backed Securities

The mortgage-backed securities that we acquire provide funds for mortgage loans made primarily to residential homeowners. Our securities generally represent interests in pools of mortgage loans made by savings and loan institutions, mortgage bankers, commercial banks and other mortgage lenders. These pools of mortgage loans are assembled for sale to investors (like us) by various government, government-related and private organizations.

Mortgage-backed securities differ from other forms of traditional debt securities, which normally provide for periodic payments of interest in fixed amounts with principal payments at maturity or on specified call dates. Instead, mortgage-backed securities provide for a monthly payment, which consists of both interest and principal. In effect, these payments are a "pass-through" of the monthly interest and principal payments made by the individual borrower on the mortgage loans, net of any fees paid to the issuer or guarantor of the securities. Additional payments result from prepayments of principal upon the sale, refinancing or foreclosure of the underlying residential property, net of fees or costs which may be incurred. Some mortgage-backed securities, such as securities issued by Ginnie Mae, are described as "modified pass-through". These securities entitle the holder to receive all interest and principal payments owed on the mortgage pool, net of certain fees, regardless of whether the mortgagors actually make mortgage payments when due.

The investment characteristics of pass-through mortgage-backed securities differ from those of traditional fixed-income securities. The major differences include the payment of interest and principal on the mortgage-backed securities on a more frequent schedule, as described above, and the possibility that principal may be prepaid at any time due to prepayments on the underlying mortgage loans or other assets. These differences can result in significantly greater price and yield volatility than is the case with traditional fixed-income securities.

Various factors affect the rate at which mortgage prepayments occur, including changes in interest rates, general economic conditions, the age of the mortgage loan, the location of the property and other social and demographic conditions. Generally prepayments on mortgage-backed securities increase during periods of falling mortgage interest

rates and decrease during periods of rising mortgage interest rates. We may reinvest prepayments at a yield that is higher or lower than the yield on the prepaid investment, thus affecting the weighted average yield of our investments.

To the extent mortgage-backed securities are purchased at a premium, faster than expected prepayments result in a faster than expected amortization of the premium paid. Conversely, if these securities were purchased at a discount, faster than expected prepayments accelerate our recognition of income.

CMOs may allow for shifting of prepayment risk from slower-paying tranches to faster-paying tranches. This is in contrast to mortgage pass-through certificates where all investors share equally in all payments, including all prepayments, on the underlying mortgages.

Freddie Mac Certificates

Freddie Mac is a privately-owned government-sponsored enterprise created pursuant to an Act of Congress on July 24, 1970. On September 6, 2008, the Federal Housing Finance Agency, (or FHFA), placed Freddie Mac into conservatorship. As the conservator of Freddie Mac, the FHFA controls and directs Freddie Mac's operations. The principal activity of Freddie Mac currently consists of the purchase of mortgage loans or participation interests in mortgage loans and the resale of the loans and participations in the form of guaranteed mortgage-backed securities. Freddie Mac guarantees to each holder of Freddie Mac certificates the timely payment of interest at the applicable pass-through rate and ultimate collection of all principal on the holder's pro rata share of the unpaid principal balance of the related mortgage loans, but does not guarantee the timely payment of scheduled principal of the underlying mortgage loans. Notwithstanding the conservatorship of Freddie Mac by the FHFA, the obligations of Freddie Mac under its guarantees are solely those of Freddie Mac and are not backed by the full faith and credit of the United States. If Freddie Mac were unable to satisfy these obligations, distributions to holders of Freddie Mac certificates would consist solely of payments and other recoveries on the underlying mortgage loans and, accordingly, defaults and delinquencies on the underlying mortgage loans would adversely affect monthly distributions to holders of Freddie Mac certificates.

Freddie Mac certificates may be backed by pools of single-family mortgage loans or multi-family mortgage loans. These underlying mortgage loans may have original terms to maturity of up to 40 years. Freddie Mac certificates may be issued under cash programs (composed of mortgage loans purchased from a number of sellers) or guarantor programs (composed of mortgage loans acquired from one seller in exchange for certificates representing interests in the mortgage loans purchased).

Freddie Mac certificates may pay interest at a fixed rate or an adjustable rate. The interest rate paid on adjustable-rate Freddie Mac certificates (Freddie Mac ARMs) adjusts periodically within 60 days prior to the month in which the interest rates on the underlying mortgage loans adjust. The interest rates paid on certificates issued under Freddie Mac's standard ARM programs adjust in relation to the Treasury index. Other specified indices used in Freddie Mac ARM programs include the 11th District Cost of Funds Index published by the Federal Home Loan Bank of San Francisco, LIBOR and other indices. Interest rates paid on fully-indexed Freddie Mac ARM certificates equal the applicable index rate plus a specified number of basis points. The majority of the series of Freddie Mac ARM certificates issued to date have evidenced pools of mortgage loans with monthly, semi-annual or annual interest adjustments. Adjustments in the interest rates paid are generally limited to an annual increase or decrease of either 100 or 200 basis points and to a lifetime cap of 500 or 600 basis points over the initial interest rate. Certain Freddie Mac programs include mortgage loans which allow the borrower to convert the adjustable mortgage interest rate to a fixed rate. Adjustable-rate mortgages which are converted into fixed-rate mortgage loans are repurchased by Freddie Mac or by the seller of the loan to Freddie Mac at the unpaid principal balance of the loan plus accrued interest to the due date of the last adjustable rate interest payment.

Fannie Mae Certificates

Fannie Mae is a privately-owned, federally-chartered corporation organized and existing under the Federal National Mortgage Association Charter Act. On September 6, 2008, the FHFA placed Fannie Mae into conservatorship. As the conservator of Fannie Mae, the FHFA controls and directs Fannie Mae's operations. Fannie Mae provides funds to the mortgage market primarily by purchasing home mortgage loans from local lenders, thereby replenishing their funds for additional lending. Fannie Mae guarantees to the registered holder of a Fannie Mae certificate that it will

distribute amounts representing scheduled principal and interest on the mortgage loans in the pool underlying the Fannie Mae certificate, whether or not received, and the full principal amount of any such mortgage loan foreclosed or otherwise finally liquidated, whether or not the principal amount is actually received. Notwithstanding the conservatorship of Fannie Mae by the FHFA, the obligations of Fannie Mae under its guarantees are solely those of Fannie Mae and are not backed by the full faith and credit of the United States. If Fannie Mae were unable to satisfy its obligations, distributions to holders of Fannie Mae certificates would consist solely of payments and other recoveries on the underlying mortgage loans and, accordingly, defaults and delinquencies on the underlying mortgage loans would adversely affect monthly distributions to holders of Fannie Mae.

Fannie Mae certificates may be backed by pools of single-family or multi-family mortgage loans. The original term to maturity of any such mortgage loan generally does not exceed 40 years. Fannie Mae certificates may pay interest at a fixed rate or an adjustable rate. Each series of Fannie Mae ARM certificates bears an initial interest rate and margin tied to an index based on all loans in the related pool, less a fixed percentage representing servicing compensation and Fannie Mae's guarantee fee. The specified index used in different series has included the Treasury Index, the 11th District Cost of Funds Index published by the Federal Home Loan Bank of San Francisco, LIBOR and other indices. Interest rates paid on fully-indexed Fannie Mae ARM certificates equal the applicable index rate plus a specified number of basis points. The majority of series of Fannie Mae ARM certificates issued to date have evidenced pools of mortgage loans with monthly, semi-annual or annual interest rate adjustments. Adjustments in the interest rates paid are generally limited to an annual increase or decrease of either 100 or 200 basis points and to a lifetime cap of 500 or 600 basis points over the initial interest rate. Certain Fannie Mae programs include mortgage loans which allow the borrower to convert the adjustable mortgage interest rate of the ARM to a fixed rate. Adjustable-rate mortgages which are converted into fixed-rate mortgage loans are repurchased by Fannie Mae or by the seller of the loans to Fannie Mae at the unpaid principal of the loan plus accrued interest to the due date of the last adjustable rate interest payment. Adjustments to the interest rates on Fannie Mae ARM certificates are typically subject to lifetime caps and periodic rate or payment caps.

Ginnie Mae Certificates

Ginnie Mae is a wholly owned corporate instrumentality of the United States within the Department of Housing and Urban Development (HUD). The National Housing Act of 1934 authorizes Ginnie Mae to guarantee the timely payment of the principal and interest on certificates which represent an interest in a pool of mortgages insured by the Federal Housing Administration (FHA) or partially guaranteed by the Department of Veterans Affairs and other loans eligible for inclusion in mortgage pools underlying Ginnie Mae certificates. Section 306(g) of the Housing Act provides that the full faith and credit of the United States is pledged to the payment of all amounts which may be required to be paid under any guaranty by Ginnie Mae.

At present, most Ginnie Mae certificates are backed by single-family mortgage loans. The interest rate paid on Ginnie Mae certificates may be a fixed rate or an adjustable rate. The interest rate on Ginnie Mae certificates issued under Ginnie Mae's standard ARM program adjusts annually in relation to the Treasury index. Adjustments in the interest rate are generally limited to an annual increase or decrease of 100 basis points and to a lifetime cap of 500 basis points over the initial coupon rate.

Single-Family and Multi-Family Privately-Issued Certificates

Single-family and multi-family privately-issued certificates are pass-through certificates that are not issued by one of the Agencies and that are backed by a pool of conventional single-family or multi-family mortgage loans. These certificates are issued by originators of, investors in, and other owners of mortgage loans, including savings and loan associations, savings banks, commercial banks, mortgage banks, investment banks and special purpose "conduit" subsidiaries of these institutions.

While Agency pass-through certificates are backed by the express obligation or guarantee of one of the Agencies, as described above, privately-issued certificates are generally covered by one or more forms of private (i.e., non-governmental) credit enhancements. These credit enhancements provide an extra layer of loss coverage in the event that losses are incurred upon foreclosure sales or other liquidations of underlying mortgaged properties in amounts that exceed the equity holder's equity interest in the property. Forms of credit enhancements include limited issuer guarantees, reserve funds, private mortgage guaranty pool insurance, over-collateralization and subordination.

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Subordination is a form of credit enhancement frequently used and involves the issuance of classes of senior and subordinated mortgage-backed securities. These classes are structured into a hierarchy to allocate losses on the underlying mortgage loans and also for defining priority of rights to payment of principal and interest. Typically, one or more classes of senior securities are created which are rated in one of the two highest rating levels by one or more nationally recognized rating agencies and which are supported by one or more classes of mezzanine securities and subordinated securities that bear losses on the underlying loans prior to the classes of senior securities. Mezzanine securities, as used in this Form 10-K, refers to classes that are rated below the two highest levels, but no lower than a single "B" rating under the S&P rating system (or comparable level under other rating systems) and are supported by one or more classes of subordinated securities which bear realized losses prior to the classes of mezzanine securities. Subordinated securities, as used in this Form 10-K, refers to any class that bears the "first loss" from losses from underlying mortgage loans or that is rated below a single "B" level (or, if unrated, we deem it to be below that level). In some cases, only classes of senior securities and subordinated securities are issued. By adjusting the priority of interest and principal payments on each class of a given series of senior-subordinated mortgage-backed securities, issuers are able to create classes of mortgage-backed securities with varying degrees of credit exposure, prepayment exposure and potential total return, tailored to meet the needs of sophisticated institutional investors.

Collateralized Mortgage Obligations and Multi-Class Pass-Through Securities

We may also invest in CMOs and multi-class pass-through securities. CMOs are debt obligations issued by special purpose entities that are secured by mortgage loans or mortgage-backed certificates, including, in many cases, certificates issued by government and government-related guarantors, including, Ginnie Mae, Fannie Mae and Freddie Mac, together with certain funds and other collateral. Multi-class pass-through securities are equity interests in a trust composed of mortgage loans or other mortgage-backed securities. Payments of principal and interest on underlying collateral provide the funds to pay debt service on the CMO or make scheduled distributions on the multi-class pass-through securities. CMOs and multi-class pass-through securities may be issued by agencies or instrumentalities of the U.S. Government or by private organizations. The discussion of CMOs in the following paragraphs is similarly applicable to multi-class pass-through securities.

In a CMO, a series of bonds or certificates is issued in multiple classes. Each class of CMOs, often referred to as a "tranche," is issued at a specific coupon rate (which, as discussed below, may be an adjustable rate subject to a cap) and has a stated maturity or final distribution date. Principal prepayments on collateral underlying a CMO may cause it to be retired substantially earlier than the stated maturity or final distribution date. Interest is paid or accrues on all classes of a CMO on a monthly, quarterly or semi-annual basis. The principal and interest on underlying mortgages may be allocated among the several classes of a series of a CMO in many ways. In a common structure, payments of principal, including any principal prepayments, on the underlying mortgages are applied to the classes of the series of a CMO in the order of their respective stated maturities or final distribution dates, so that no payment of principal will be made on any class of a CMO until all other classes having an earlier stated maturity or final distribution date have been paid in full.

Other types of CMO issues include classes such as parallel pay CMOs, some of which, such as planned amortization class CMOs (or PAC bonds), provide protection against prepayment uncertainty. Parallel pay CMOs are structured to provide payments of principal on certain payment dates to more than one class. These simultaneous payments are taken into account in calculating the stated maturity date or final distribution date of each class which, as with other CMO structures, must be retired by its stated maturity date or final distribution date but may be retired earlier. PAC bonds generally require payment of a specified amount of principal on each payment date so long as prepayment speeds on the underlying collateral fall within a specified range.

Other types of CMO issues include targeted amortization class CMOs (or TAC bonds), which are similar to PAC bonds. While PAC bonds maintain their amortization schedule within a specified range of prepayment speeds, TAC

bonds are generally targeted to a narrow range of prepayment speeds or a specified prepayment speed. TAC bonds can provide protection against prepayment uncertainty since cash flows generated from higher prepayments of the underlying mortgage-related assets are applied to the various other pass-through tranches so as to allow the TAC bonds to maintain their amortization schedule.

A CMO may be subject to the issuer's right to redeem the CMO prior to its stated maturity date, which may diminish the anticipated return on our investment. Privately-issued CMOs are supported by private credit enhancements similar to those used for privately-issued certificates and are often issued as senior-subordinated mortgage-backed securities. We will only acquire CMOs or multi-class pass-through certificates that constitute debt obligations or beneficial ownership in grantor trusts holding mortgage loans, or regular interests in REMICs, or that otherwise constitute qualified REIT real estate assets under the Internal Revenue Code (provided that we have obtained a favorable opinion of our tax advisor or a ruling from the IRS to that effect).

Adjustable-Rate Mortgage Pass-Through Certificates and Floating Rate Mortgage-Backed Securities

Some of the mortgage pass-through certificates we acquire are adjustable-rate mortgage pass-through certificates. This means that their interest rates may vary over time based upon changes in an objective index, such as:

- LIBOR or the London Interbank Offered Rate. The interest rate that banks in London offer for deposits in London of U.S. dollars.

- Treasury Index. A monthly or weekly average yield of benchmark U.S. Treasury securities, as published by the Federal Reserve Board.

These indices generally reflect short-term interest rates. The underlying mortgages for adjustable-rate mortgage pass-through certificates are adjustable-rate mortgage loans (or ARMs).

We also acquire CMO floaters. One or more tranches of a CMO may have coupon rates that reset periodically at a specified increment over an index such as LIBOR. These adjustable-rate tranches are sometimes known as CMO floaters and may be backed by fixed or adjustable-rate mortgages.

There are two main categories of indices for adjustable-rate mortgage pass-through certificates and floaters: (1) those based on U.S. Treasury securities, and (2) those derived from calculated measures such as a cost of funds index or a moving average of mortgage rates. Commonly utilized indices include the one-year Treasury note rate, the three-month Treasury bill rate, the six-month Treasury bill rate, rates on long-term Treasury securities, the 11th District Federal Home Loan Bank Costs of Funds Index, the National Median Cost of Funds Index, one-month or three-month LIBOR, the prime rate of a specific bank, or commercial paper rates. Some indices, such as the one-year Treasury rate, closely mirror changes in market interest rate levels. Others, such as the 11th District Home Loan Bank Cost of Funds Index, tend to lag changes in market interest rate levels. We seek to diversify our investments in adjustable-rate mortgage pass-through certificates and floaters among a variety of indices and reset periods so that we are not at any one time unduly exposed to the risk of interest rate fluctuations. In selecting adjustable-rate mortgage pass-through certificates and floaters for investment, we will also consider the liquidity of the market for the different mortgage-backed securities.

Adjustable-rate mortgage pass-through certificates and floaters typically have caps, which limit the maximum amount by which the interest rate may be increased or decreased at periodic intervals or over the life of the security. To the extent that interest rates rise faster than the allowable caps on the adjustable-rate mortgage pass-through certificates and floaters, these securities will behave more like fixed-rate securities. Consequently, interest rate increases in excess of caps can be expected to cause these securities to behave more like traditional debt securities than adjustable-rate interest-earning assets and, accordingly, to decline in value to a greater extent than would be the case in the absence of these caps.

Adjustable-rate mortgage pass-through certificates and floaters, like other mortgage-backed securities, differ from conventional bonds in that principal is to be paid back over the life of the security rather than at maturity. As a result,

we receive monthly scheduled payments of principal and interest on these securities and may receive unscheduled principal payments representing prepayments on the underlying mortgages. When we reinvest the payments and any unscheduled prepayments we receive, we may receive a rate of interest on the reinvestment which is lower than the rate on the existing security. For this reason, adjustable-rate mortgage pass-through certificates and floaters are less effective than longer-term debt securities as a means of "locking in" longer-term interest rates. Accordingly, adjustable-rate mortgage pass-through certificates and floaters, while generally having less risk of price decline during periods of rapidly rising interest rates than fixed-rate mortgage-backed securities of comparable maturities, have less potential for capital appreciation than fixed-rate securities during periods of declining interest rates.

As in the case of fixed-rate mortgage-backed securities, to the extent these securities are purchased at a premium, faster than expected prepayments would accelerate our amortization of the premium. Conversely, if these securities were purchased at a discount, faster than expected prepayments would accelerate our recognition of income.

Fixed-rate CMOs and floating-rate CMOs may allow for shifting of prepayment risk from slower-paying tranches to faster-paying tranches. This is in contrast to mortgage pass-through certificates where all investors share equally in all payments, including all prepayments, on the underlying mortgages.

Other Floating Rate Instruments

We may also invest in structured floating-rate notes issued or guaranteed by government agencies, such as Fannie Mae and Freddie Mac. These instruments are typically structured to reflect an interest rate arbitrage (i.e., the difference between the agency's cost of funds and the income stream from specified assets of the agency) and their reset formulas may provide more attractive returns than other floating rate instruments. The indices used to determine resets are the same as those described above.

Mortgage Loans

We may from time-to-time through our subsidiary Shannon invest a small percentage of our assets directly in the ownership or financing of single-family, multi-family or commercial mortgage loans. The acquisition or financing of mortgage loans generally involves credit risk. We may obtain credit enhancement to mitigate this risk; however, there can be no assurances that we will be able to obtain credit enhancement or that credit enhancement would mitigate the credit risk of the underlying mortgage loans.

Middle Market Lending

We may from time-to-time through our subsidiary Charlesfort invest a small percentage of our assets directly in the ownership of corporate loans for middle market companies. The acquisition of such corporate loans generally involves credit risk directly related to the middle market company obtaining the loan. We may obtain credit enhancement to mitigate this risk; however, there can be no assurances that we will be able to obtain credit enhancement or that credit enhancement would mitigate the credit risk of the underlying corporate loans.

Capital Investment Policy

Asset Acquisitions

Our capital investment policy provides that at least 75% of our total assets will be comprised of high quality mortgage-backed securities and short-term investments. The remainder of our assets (comprising not more than 25% of total assets), may consist of mortgage-backed securities and other qualified REIT real estate assets which are unrated or rated less than high quality but which are at least "investment grade" (rated "BBB" or better) or, if not rated, are determined by us to be of comparable credit quality to an investment which is rated "BBB" or better. In addition, we may directly or indirectly invest part of this remaining 25% of our assets in other types of securities, including without limitation, unrated debt, equity or derivative securities, to the extent consistent with our REIT qualification requirements. The derivative securities in which we invest may include securities representing the right to receive interest only or a disproportionately large amount of interest, as well as inverse floaters, which may have imbedded leverage as part of their structural characteristics.

Our capital investment policy requires that we structure our portfolio to maintain a minimum weighted average rating (including our deemed comparable ratings for unrated mortgage-backed securities) of our mortgage-backed securities

of at least single “A” under the S&P rating system and at the comparable level under the other rating systems. To date, substantially all of the mortgage-backed securities we have acquired have been pass-through certificates or CMOs issued or guaranteed by Freddie Mac, Fannie Mae or Ginnie Mae which, although not rated, have an implied “AAA” rating.

We intend to acquire only those mortgage-backed securities that we believe we have the necessary expertise to evaluate and manage, that we can readily finance and that are consistent with our balance sheet guidelines and risk management objectives. Since we expect to hold our mortgage-backed securities until maturity, we generally do not seek to acquire assets whose investment returns are only attractive in a limited range of scenarios. We believe that future interest rates and mortgage prepayment rates are very difficult to predict and, as a result, we seek to acquire mortgage-backed securities which we believe provide acceptable returns over a broad range of interest rate and prepayment scenarios.

Among the asset choices available to us, our policy is to acquire those mortgage-backed securities which we believe generate the highest returns on capital invested, after consideration of the following:

- the amount and nature of anticipated cash flows from the asset;
- our ability to pledge the asset to secure collateralized borrowings;
- the increase in our capital requirement determined by our capital investment policy resulting from the purchase and financing of the asset; and
- the costs of financing, hedging and managing the asset.

Prior to acquisition, we assess potential returns on capital employed over the life of the asset and in a variety of interest rate, yield spread, financing cost, credit loss and prepayment scenarios.

We also give consideration to balance sheet management and risk diversification issues. We deem a specific asset which we are evaluating for potential acquisition as more or less valuable to the extent it serves to increase or decrease certain interest rate or prepayment risks which may exist in the balance sheet, to diversify or concentrate credit risk, and to meet the cash flow and liquidity objectives our management may establish for our balance sheet from time-to-time. Accordingly, an important part of the asset evaluation process is a simulation, using risk management models, of the addition of a potential asset and our associated borrowings and hedges to the balance sheet and an assessment of the impact this potential asset acquisition would have on the risks in and returns generated by our balance sheet as a whole over a variety of scenarios.

We believe that adjustable-rate mortgage pass-through certificates and floaters are particularly well-suited to our investment objective of high current income, consistent with modest volatility of net asset value, because the value of adjustable-rate mortgage pass-through certificates and floaters generally remains relatively stable as compared to traditional fixed-rate debt securities paying comparable rates of interest. We have, however, purchased a significant amount of fixed-rate mortgage-backed securities and may continue to do so in the future if, in our view, the potential returns on capital invested, after hedging and all other costs, would exceed the returns available from other assets or if the purchase of these assets would serve to reduce or diversify the risks of our balance sheet.

We may purchase the stock of mortgage REITs or similar companies when we believe that these purchases would yield attractive returns on capital employed. We do not, however, presently intend to invest in the securities of other issuers for the purpose of exercising control of other issuers.

We may acquire newly issued mortgage-backed securities, and also may seek to expand our capital base in order to further increase our ability to acquire new assets, when the potential returns from new investments appears attractive relative to the return expectations of stockholders. We may in the future acquire mortgage-backed securities by offering our debt or equity securities in exchange for the mortgage-backed securities.

We generally intend to hold mortgage-backed securities for extended periods. In addition, the REIT provisions of the Internal Revenue Code limit in certain respects our ability to sell mortgage-backed securities. We may decide however to sell assets from time to time, for a number of reasons, including our desire to dispose of an asset as to which credit risk concerns have arisen, to reduce interest rate risk, to substitute one type of mortgage-backed security for another, to improve yield or to maintain compliance with the 55% requirement of Section 3(c)(5)(C) of the Investment Company Act, or generally to re-structure the balance sheet when we deem advisable. Our board of directors has not adopted any policy that would restrict management's authority to determine the timing of sales or the selection of mortgage-backed securities to be sold.

We do not invest in REMIC residuals or other CMO residuals.

As a requirement for maintaining REIT status, we will distribute to stockholders aggregate dividends equaling at least 90% of our REIT taxable income for each taxable year. We will make additional distributions of capital when the return expectations of the stockholders appear to exceed returns potentially available to us through making new investments in mortgage-backed securities. Subject to the limitations of applicable securities and state corporation laws, we can distribute capital by making purchases of our own capital stock or through paying down or repurchasing any outstanding uncollateralized debt obligations.

Our asset acquisition strategy may change over time as market conditions change and as we evolve.

Credit Risk Management

Although we do not expect to encounter credit risk in our Agency mortgage-backed securities and Agency debentures, we face credit risk on the portions of our portfolio which are not mortgage-backed securities and Agency debentures. In addition, our use of repurchase agreements and interest rate swaps creates exposure to credit risk relating to potential losses that could be recognized if the counterparties to these instruments fail to perform their obligations under the contracts. In the event of a default by the counterparty, we could have difficulty obtaining our Agency mortgage-backed securities pledged as collateral. We review credit risk and other risk of loss associated with each investment and determine the appropriate allocation of capital to apply to the investment under our capital investment policy. Our management will monitor the overall portfolio risk and determine appropriate levels of provision for loss.

Capital and Leverage

We expect generally to maintain a debt-to-equity ratio of between 8:1 and 12:1, although the ratio may vary, as it currently does because of market conditions, from this range from time to time based upon various factors, including our management's opinion of the level of risk of our assets and liabilities, our liquidity position, our level of unused borrowing capacity and over-collateralization levels required by lenders when we pledge assets to secure borrowings. For purposes of calculating this ratio, our equity (or capital base) is equal to the value of our investment portfolio on a mark-to-market basis less the book value of our obligations under repurchase agreements and other collateralized borrowings. For the calculation of this ratio, equity includes the Series B Cumulative Convertible Preferred Stock, which is not included in equity under Generally Accepted Accounting Principles.

Our goal is to strike a balance between the under-utilization of leverage, which reduces potential returns to stockholders, and the over-utilization of leverage, which could reduce our ability to meet our obligations during adverse market conditions. Our capital investment policy limits our ability to acquire additional assets during times when our debt-to-equity ratio exceeds 12:1. At December 31, 2011, our ratio of debt-to-equity was 5.4:1. Our capital base represents the approximate liquidation value of our investments and approximates the market value of assets that we can pledge or sell to meet over-collateralization requirements for our borrowings. The unpledged portion of our capital base is available for us to pledge or sell as necessary to maintain over-collateralization levels for our borrowings.

Unless our board of directors determines otherwise, we are prohibited from acquiring additional assets during periods when our capital base is less than the minimum amount required under our capital investment policy, except as may be necessary to maintain REIT status or our exemption from the Investment Company Act of 1940, as amended (or the Investment Company Act). In addition, when our capital base falls below our risk-managed capital requirement, our management is required to submit to our board of directors a plan for bringing our capital base into compliance with our capital investment policy guidelines. We anticipate that in most circumstances we can achieve this goal

without overt management action through the natural process of mortgage principal repayments. We anticipate that our capital base is likely to exceed our risk-managed capital requirement during periods following new equity offerings and during periods of falling interest rates and that our capital base could fall below the risk-managed capital requirement during periods of rising interest rates.

The first component of our capital requirement is the current aggregate over-collateralization amount or "haircut" the lenders require us to hold as capital. The haircut for each mortgage-backed security is determined by our lenders based on the risk characteristics and liquidity of the asset. Should the market value of our pledged assets decline, we will be required to deliver additional collateral to our lenders to maintain a constant over-collateralization level on our borrowings.

The second component of our capital requirement is the "excess capital cushion." This is an amount of capital in excess of the haircuts required by our lenders. We maintain the excess capital cushion to meet the demands of our lenders for additional collateral should the market value of our mortgage-backed securities decline. The aggregate excess capital cushion equals the sum of liquidity cushion amounts assigned under our capital investment policy to each of our mortgage-backed securities. We assign excess capital cushions to each mortgage-backed security based on our assessment of the mortgage-backed security's market price volatility, credit risk, liquidity and attractiveness for use as collateral by lenders. The process of assigning excess capital cushions relies on our management's ability to identify and weigh the relative importance of these and other factors. In assigning excess capital cushions, we also give consideration to hedges associated with the mortgage-backed security and any effect such hedges may have on reducing net market price volatility, concentration or diversification of credit and other risks in the balance sheet as a whole and the net cash flows that we can expect from the interaction of the various components of our balance sheet.

Our capital investment policy stipulates that at least 25% of the capital base maintained to satisfy the excess capital cushion must be invested in AAA-rated adjustable-rate mortgage-backed securities or assets with similar or better liquidity characteristics.

A substantial portion of our borrowings are short-term or variable-rate borrowings. Our borrowings are implemented primarily through repurchase agreements, but in the future may also be obtained through loan agreements, lines of credit, dollar-roll agreements (an agreement to sell a security for delivery on a specified future date and a simultaneous agreement to repurchase the same or a substantially similar security on a specified future date) and other credit facilities with institutional lenders and issuance of debt securities such as commercial paper, medium-term notes, CMOs and senior or subordinated notes. We enter into financing transactions only with institutions that we believe are sound credit risks and follow other internal policies designed to limit our credit and other exposure to financing institutions.

We expect to continue to use repurchase agreements as our principal financing device to leverage our mortgage-backed securities portfolio. We anticipate that, upon repayment of each borrowing under a repurchase agreement, we will use the collateral immediately for borrowing under a new repurchase agreement. We have not at the present time entered into any commitment agreements under which the lender would be required to enter into new repurchase agreements during a specified period of time, nor do we presently plan to have liquidity facilities with commercial banks. We may, however, enter into such commitment agreements in the future. We enter into repurchase agreements primarily with national broker-dealers, commercial banks and other lenders which typically offer this type of financing. We enter into collateralized borrowings only with financial institutions meeting credit standards approved by our board of directors, and we monitor the financial condition of these institutions on a regular basis.

A repurchase agreement, although structured as a sale and repurchase obligation, acts as a financing under which we effectively pledge our mortgage-backed securities as collateral to secure a short-term loan. Generally, the other party to the agreement makes the loan in an amount equal to a percentage of the market value of the pledged collateral. At the maturity of the repurchase agreement, we are required to repay the loan and correspondingly receive back our collateral. While used as collateral, the mortgage-backed securities continue to pay principal and interest which are for our benefit. In the event of our insolvency or bankruptcy, certain repurchase agreements may qualify for special treatment under the Bankruptcy Code, the effect of which, among other things, would be to allow the creditor under the agreement to avoid the automatic stay provisions of the Bankruptcy Code and to foreclose on the collateral

without delay. In the event of the insolvency or bankruptcy of a lender during the term of a repurchase agreement, the lender may be permitted, under applicable insolvency laws, to repudiate the contract, and our claim against the lender for damages may be treated simply as an unsecured creditor. In addition, if the lender is a broker or dealer subject to the Securities Investor Protection Act of 1970, or an insured depository institution subject to the Federal Deposit Insurance Act, our ability to exercise our rights to recover our securities under a repurchase agreement or to be compensated for any damages resulting from the lender's insolvency may be further limited by those statutes. These claims would be subject to significant delay and, if and when received, may be substantially less than the damages we actually incur.

Substantially all of our collateralized borrowing agreements require us to deposit additional collateral in the event the market value of existing collateral declines, which may require us to sell assets to reduce our borrowings. We have designed our liquidity management policy to maintain a cushion of equity sufficient to provide required liquidity to respond to the effects under our borrowing arrangements of interest rate movements and changes in market value of our mortgage-backed securities, as described above. However, a major disruption of the repurchase or other market that we rely on for short-term borrowings would have a material adverse effect on us unless we were able to arrange alternative sources of financing on comparable terms.

Our articles of incorporation and bylaws do not limit our ability to incur borrowings, whether secured or unsecured.

Interest Rate Risk Management

To the extent consistent with our election to qualify as a REIT, we follow an interest rate risk management program intended to protect our portfolio of mortgage-backed securities and related debt against the effects of major interest rate changes. Specifically, our interest rate risk management program is formulated with the intent to offset the potential adverse effects resulting from rate adjustment limitations on our mortgage-backed securities and the differences between interest rate adjustment indices and interest rate adjustment periods of our adjustable-rate mortgage-backed securities and related borrowings.

We adjust the average maturity adjustment periods of our borrowings on an ongoing basis by changing the mix of maturities and interest rate adjustment periods as borrowings come due and are renewed. Through use of these procedures, we attempt to minimize the differences between the interest rate adjustment periods of our mortgage-backed securities and related borrowings that may occur.

We enter into interest rate swaps. We may from time to time enter into interest rate collars, interest rate caps or floors, purchase interest rate swaptions and purchase interest-only mortgage-backed securities and similar instruments to attempt to mitigate the risk of the cost of our variable rate liabilities increasing at a faster rate than the earnings on our assets during a period of rising interest rates or to mitigate prepayment risk. We may hedge as much of the interest rate risk as our management determines is in our best interests, given the cost of the hedging transactions and the need to maintain our status as a REIT. This determination may result in our electing to bear a level of interest rate or prepayment risk that could otherwise be hedged when management believes, based on all relevant facts, that bearing the risk is advisable.

We seek to build a balance sheet and undertake an interest rate risk management program which is likely to generate positive earnings and maintain an equity liquidation value sufficient to maintain operations given a variety of potentially adverse circumstances. Accordingly, our interest rate risk management program addresses both income preservation, as discussed above, and capital preservation concerns. For capital preservation, we monitor our "duration." This is the expected percentage change in market value of our assets that would be caused by a 1% change in short and long-term interest rates. To monitor weighted average duration and the related risks of fluctuations in the liquidation value of our equity, we model the impact of various economic scenarios on the market value of our mortgage-backed securities and liabilities. At December 31, 2011, we estimate that the duration of our assets was 1.2 years and giving effect to the swap transactions, our weighted average duration was (0.4) years. We believe that our interest rate risk management program will allow us to maintain operations throughout a wide variety of potentially adverse circumstances. Nevertheless, in order to further preserve our capital base (and lower our duration) during periods when we believe a trend of rapidly rising interest rates has been established, we may decide to increase hedging activities or to sell assets. Each of these actions may lower our earnings and dividends in the short term to further our objective of maintaining attractive levels of earnings and dividends over the long term.

We may elect to conduct a portion of our hedging operations through one or more subsidiary corporations, each of which we would elect to treat as a "taxable REIT subsidiary." To comply with the asset tests applicable to us as a REIT, we could own 100% of the voting stock of such subsidiary, provided that the value of the stock that we own in all such taxable REIT subsidiaries does not exceed 25% of the value of our total assets at the close of any calendar quarter. A taxable subsidiary, such as FIDAC, Merganser, and RCap, would not elect REIT status and would distribute any net profit after taxes to us. Any dividend income we receive from the taxable subsidiaries (combined with all other income generated from our assets, other than qualified REIT real estate assets) must not exceed 25% of our gross income.

We believe that we have developed a cost-effective asset/liability management program to provide a level of protection against interest rate and prepayment risks. However, no strategy can completely insulate us from interest rate changes and prepayment risks. Further, as noted above, the federal income tax requirements that we must satisfy to qualify as a REIT limit our ability to hedge our interest rate and prepayment risks. We monitor carefully, and may have to limit, our asset/liability management program to assure that we do not realize excessive hedging income, or hold hedging assets having excess value in relation to total assets, which could result in our disqualification as a REIT, the payment of a penalty tax for failure to satisfy certain REIT tests under the Internal Revenue Code, provided the failure was for reasonable cause. In addition, asset/liability management involves transaction costs which increase dramatically as the period covered by the hedging protection increases. Therefore, we may be unable to hedge effectively our interest rate and prepayment risks.

Prepayment Risk Management

We seek to minimize the effects of faster or slower than anticipated prepayment rates through structuring a diversified portfolio with a variety of prepayment characteristics, investing in mortgage-backed securities with prepayment prohibitions and penalties, investing in certain mortgage-backed security structures which have prepayment protections, and balancing assets purchased at a premium with assets purchased at a discount. We monitor prepayment risk through periodic review of the impact of a variety of prepayment scenarios on our revenues, net earnings, dividends, cash flow and net balance sheet market value.

Future Revisions in Policies and Strategies

Our board of directors has established the investment policies and operating policies and strategies set forth in this Form 10-K. The board of directors has the power to modify or waive these policies and strategies without the consent of the stockholders to the extent that the board of directors determines that the modification or waiver is in the best interests of our stockholders. Among other factors, developments in the market which affect our policies and strategies or which change our assessment of the market may cause our board of directors to revise our policies and strategies.

Potential Acquisitions, Strategic Alliances and Other Investments

From time-to-time we have explored possible transactions to enhance our operations and growth, including entering into new businesses, acquisitions of other businesses or assets, investments in other entities, joint venture arrangements, or strategic alliances. We entered into the broker-dealer business during the first quarter of January 2009, through our subsidiary RCap, which was granted membership in FINRA in January 2009. On October 31, 2008 we consummated our acquisition of Merganser which is a registered investment advisor. We own approximately 45.0 million shares of common stock of Chimera Investment Corporation, (or Chimera). Chimera is a publicly traded, specialty finance company that acquires, manages, and finances, directly or through its subsidiaries, residential mortgage loans, residential mortgage-backed securities, real estate related securities and various other asset classes. Chimera is externally managed by FIDAC and has elected and qualifies to be taxed as a REIT for federal income tax purposes. We own approximately 9.5 million shares of common stock of CreXus Investment Corp., (or CreXus). CreXus is a publicly traded, specialty finance company that acquires, manages, and finances, directly or through its subsidiaries, commercial mortgage loans and other commercial real estate debt, commercial mortgage-backed securities, or CMBS, and other commercial real estate-related assets. CreXus is externally managed by FIDAC and has elected and qualifies to be taxed as a REIT for federal income tax purposes.

We may, from time-to-time, continue to explore possible new businesses, acquisitions, investments, joint venture arrangements and strategic alliances which may enhance our operations and assist our and our subsidiaries' growth. These transactions could be material to our financial condition and results of operations. The process of integrating an

acquired company or business create unforeseen operating difficulties and expenditures. Our failure to address these risks or other problems encountered in connection with our past or future acquisitions and investments could cause us to fail to realize the anticipated benefits of such acquisitions or investments, incur unanticipated liabilities, and harm our business generally. Future acquisitions could also result in dilutive issuances of our equity securities, the incurrence of debt, contingent liabilities, or amortization expenses, or write-offs of goodwill, any of which could harm our financial condition. Also, the anticipated benefit of many of our acquisitions or investments may not materialize.

Dividend Reinvestment and Share Purchase Plan

We have adopted a dividend reinvestment and share purchase plan. Under the dividend reinvestment feature of the plan, existing shareholders can reinvest their dividends in additional shares of our common stock. Under the share purchase feature of the plan, new and existing shareholders can purchase shares of our common stock. We have an effective shelf registration statement on Form S-3 which registered 100,000,000 shares of common stock that could be issued under the plan. We may from time to time sell shares covered by this registration statement under the plan.

Legal Proceedings

From time-to-time, we are involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material effect on our consolidated financial statements.

Employees

As of December 31, 2011, we and our subsidiaries had 147 full time employees. None of our employees are subject to any collective bargaining agreements. We believe we have good relations with our employees.

Available Information

Our investor relations website is www.annaly.com. We make available on this website under “SEC filings,” free of charge, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports as soon as reasonably practicable after we electronically file or furnish such materials to the SEC.

COMPETITION

We believe that our principal competition in the acquisition and holding of the types of mortgage-backed securities we purchase are financial institutions such as banks, savings and loans, life insurance companies, institutional investors such as mutual funds and pension funds, and certain other mortgage REITs. Some of these entities may not be subject to the same regulatory constraints (i.e., REIT compliance or maintaining an exemption under the Investment Company Act of 1940, as amended) as us. In addition, many of these entities have greater financial resources and access to capital than us. Some of our competitors have greater financial resources and access to capital than we do. Our competitors, as well as additional competitors which may emerge in the future, may increase the competition for the acquisition of mortgage-backed securities, which in turn may result in higher prices and lower yields on such assets.

ITEM 1A. RISK FACTORS

An investment in our stock involves a number of risks. Before making an investment decision, you should carefully consider all of the risks described in this Form 10-K. If any of the risks discussed in this Form 10-K actually occur, our business, financial condition and results of operations could be materially adversely affected. If this were to occur, the trading price of our stock could decline significantly and you may lose all or part of your investment.

Risks Associated with Adverse Developments in the Mortgage Finance and Credit Markets

Volatile market conditions for mortgages and mortgage-related assets as well as the broader financial markets can result in a significant contraction in liquidity for mortgages and mortgage-related assets, which may adversely affect the value of the assets in which we invest.

Our results of operations are materially affected by conditions in the markets for mortgages and mortgage-related assets, including Agency mortgage-backed securities, as well as the broader financial markets and the economy generally. Significant adverse changes in financial market conditions can result in a deleveraging of the global financial system and the forced sale of large quantities of mortgage-related and other financial assets. Concerns over economic recession, geopolitical issues, unemployment, the availability and cost of financing, the mortgage market and a declining real estate market may contribute to increased volatility and diminished expectations for the economy and markets.

For example, as a result of the financial market conditions beginning in the summer of 2007, many traditional mortgage investors suffered severe losses in their residential mortgage portfolios and several major market participants failed or have been impaired, resulting in a significant contraction in market liquidity for mortgage-related assets. This illiquidity negatively affected both the terms and availability of financing for all mortgage-related assets. Further increased volatility and deterioration in the markets for mortgages and mortgage-related assets as well as the broader financial markets may adversely affect the performance and market value of our Agency mortgage-backed securities. If these conditions persist, institutions from which we seek financing for our investments may tighten their lending standards or become insolvent, which could make it more difficult for us to obtain financing on favorable terms or at all. Our profitability may be adversely affected if we are unable to obtain cost-effective financing for our investments. Continued adverse developments in the broader residential mortgage market may adversely affect the value of the assets in which we invest.

Since the summer of 2007, the residential mortgage market in the United States experienced a variety of difficulties and changed economic conditions, including defaults, credit losses and liquidity concerns. Certain commercial banks, investment banks and insurance companies have announced extensive losses from exposure to the residential mortgage market. These losses have reduced financial industry capital, leading to reduced liquidity for some institutions. These factors have impacted investor perception of the risk associated with Agency mortgage-backed securities in which we invest. As a result, values for Agency mortgage-backed securities in which we invest have experienced a certain amount of volatility. Further increased volatility and deterioration in the broader residential mortgage and Agency mortgage-backed securities markets may adversely affect the performance and market value of our investments. Any decline in the value of our investments, or perceived market uncertainty about their value, would likely make it difficult for us to obtain financing on favorable terms or at all, or maintain our compliance with terms of any financing arrangements already in place.

The Agency mortgage-backed securities in which we invest are classified for accounting purposes as available-for-sale. All assets classified as available-for-sale are reported at fair value with unrealized gains and losses excluded from earnings and reported as a separate component of stockholders' equity. As a result, a decline in fair values may reduce the book value of our assets. Moreover, if the decline in fair value of an available-for-sale security is other-than-temporarily impaired, such decline will reduce earnings. If market conditions result in a decline in the fair value of our Agency mortgage-backed securities, our financial position and results of operations could be adversely affected.

The potential limit or wind down of the role Fannie Mae and Freddie Mac play in the mortgage-backed securities market may adversely affect our business, operations and financial condition.

On February 11, 2011, the U.S Department of the Treasury (or Treasury) issued a White Paper titled “Reforming America's Housing Finance Market” (or the White Paper) that lays out, among other things, proposals to limit or potentially wind down the role that Fannie Mae and Freddie Mac play in the mortgage market. Any such proposals, if enacted, may have broad adverse implications for the economy, the mortgage-backed securities market and our business, operations and financial condition. We expect such proposals to be the subject of significant discussion and it is not yet possible to determine whether or when such proposals may be enacted, what form any final legislation or policies might take and how proposals, legislation or policies emanating from the White Paper may impact the economy, the mortgage-backed securities market and our business, operations and financial condition. We are evaluating, and will continue to evaluate, the potential impact of the proposals set forth in the White Paper.

The conservatorship of Fannie Mae and Freddie Mac, their reliance upon the U.S. Government for solvency, and related efforts that may significantly affect Fannie Mae and Freddie Mac and their relationship with the U.S. Government, may adversely affect our business, operations and financial condition.

Due to increased market concerns about Fannie Mae and Freddie Mac's ability to withstand future credit losses associated with securities held in their investment portfolios, and on which they provide guarantees, without the direct support of the U.S. Government Congress passed the Housing and Economic Recovery Act of 2008, (or the HERA). Among other things, the HERA established the Federal Housing Finance Agency, or FHFA, which has broad regulatory powers over Fannie Mae and Freddie Mac. On September 6, 2008, the FHFA placed Fannie Mae and Freddie Mac into conservatorship and, together with the Treasury, established a program designed to boost investor confidence in Fannie Mae's and Freddie Mac's debt and mortgage-backed securities. As the conservator of Fannie Mae and Freddie Mac, the FHFA controls and directs their operations and may (1) take over the assets of and operate Fannie Mae and Freddie Mac with all the powers of their shareholders, directors and officers of Fannie Mae and Freddie Mac and conduct all business of Fannie Mae and Freddie Mac; (2) collect all obligations and money due to Fannie Mae and Freddie Mac; (3) perform all functions of Fannie Mae and Freddie Mac which are consistent with the conservator's appointment; (4) preserve and conserve the assets and property of Fannie Mae and Freddie Mac; and (5) contract for assistance in fulfilling any function, activity, action or duty of the conservator.

In addition to FHFA becoming the conservator of Fannie Mae and Freddie Mac, the Treasury and Fannie Mae and Freddie Mac have entered into Preferred Stock Purchase Agreements (or PSPAs) pursuant to which the Treasury has ensured that each of Fannie Mae and Freddie Mac maintains a positive net worth. On December 24, 2009, the Treasury amended the terms of the PSPAs to remove the $200 billion per institution limit established under the PSPAs until the end of 2012. The Treasury also amended the PSPAs with respect to the requirements for Fannie Mae and Freddie Mac to reduce their portfolios.

The problems faced by Fannie Mae and Freddie Mac resulting in their placement into federal conservatorship and receipt of significant U.S. Government support have sparked debate among some federal policy makers regarding the continued role of the U.S. Government in providing liquidity for mortgage loans and mortgage-backed securities. With Fannie Mae's and Freddie Mac's future under debate, the nature of their guarantee obligations could be considerably limited relative to historical measurements. Any changes to the nature of their guarantee obligations could redefine what constitutes an Agency mortgage-backed security and could have broad adverse implications for the market and our business, operations and financial condition. If Fannie Mae or Freddie Mac are eliminated, or their structures change radically (i.e., limitation or removal of the guarantee obligation), we may be unable to acquire additional Agency mortgage-backed securities. A reduction in the supply of Agency mortgage-backed securities could negatively affect the pricing of Agency mortgage-backed securities by reducing the spread between the interest we earn on our portfolio of Agency mortgage-backed securities and our cost of financing that portfolio.

Although the Treasury previously committed capital to Fannie Mae and Freddie Mac through 2012, and in the White Paper the Treasury committed to providing sufficient capital to enable Fannie Mae and Freddie Mac to meet their current and future guarantee obligations, there can be no assurance that these actions will be adequate for their needs. If these actions are inadequate, Fannie Mae and Freddie Mac could continue to suffer losses and could fail to honor their guarantees and other obligations. Furthermore, the current credit support provided by the Treasury to Fannie Mae and Freddie Mac, and any additional credit support it may provide in the future, could have the effect of lowering the interest rates we expect to receive from mortgage-backed securities, and tightening the spread between the interest we earn on our mortgage-backed securities and the cost of financing those assets.

In addition, our existing Agency mortgage-backed securities could be materially and adversely impacted. We rely on our Agency mortgage-backed securities as collateral for our financings under our repurchase agreements. Any decline in their value, or perceived market uncertainty about their value, would make it more difficult for us to obtain financing on acceptable terms or at all, or to maintain our compliance with the terms of any financing transactions.

Future policies that change the relationship between Fannie Mae and Freddie Mac and the U.S. Government, including those that result in their winding down, nationalization, privatization, or elimination, may create market uncertainty and have the effect of reducing the actual or perceived credit quality of securities issued or guaranteed by Fannie Mae or Freddie Mac. As a result, such policies could increase the risk of loss on investments in Agency mortgage-backed securities guaranteed by Fannie Mae and/or Freddie Mac. It also is possible that such policies could adversely impact the market for such securities and spreads at which they trade. All of the foregoing could materially and adversely affect our business, operations and financial condition.

Mortgage loan modification programs, future legislative action and changes in the requirements necessary to qualify for refinancing a mortgage with Fannie Mae, Freddie Mac or Ginnie Mae may adversely affect the value of, and the returns on, the assets in which we invest.

The U.S. government, through the Federal Housing Administration, or FHA, and the FDIC, has implemented programs designed to provide homeowners with assistance in avoiding residential mortgage loan foreclosures including the Hope for Homeowners Act of 2008, which allows certain distressed borrowers to refinance their mortgages into FHA-insured loans. The programs may also involve, among other things, the modification of mortgage loans to reduce the principal amount of the loans or the rate of interest payable on the loans, or to extend the payment terms of the loans. Members of the U.S. Congress have indicated support for additional legislative relief for homeowners, including an amendment of the bankruptcy laws to permit the modification of mortgage loans in bankruptcy proceedings. These loan modification programs, future legislative or regulatory actions, including amendments to the bankruptcy laws, that result in the modification of outstanding mortgage loans, as well as changes in the requirements necessary to qualify for refinancing a mortgage with Fannie Mae, Freddie Mac or Ginnie Mae may adversely affect the value of, and the returns on, our Agency mortgage-backed securities and Agency debentures. Depending on whether or not we purchased an instrument at a premium or discount, the yield we receive may be positively or negatively impacted by any modification.

The U.S. Government's pressing for refinancing of certain loans may affect prepayment rates for mortgage loans in Mortgage-Backed Securities.

In addition to the increased pressure upon residential mortgage loan investors and servicers to engage in loss mitigation activities, the U.S. Government is pressing for refinancing of certain loans, and this encouragement may affect prepayment rates for mortgage loans in Agency mortgage-backed securities. To the extent these and other economic stabilization or stimulus efforts are successful in increasing prepayment speeds for residential mortgage loans, such as those in Agency mortgage-backed securities, that could potentially harm our income and operating results, particularly in connection with loans or Agency mortgage-backed securities purchased at a premium or our interest-only securities.

There can be no assurance that the actions of the U.S. Government, the Federal Reserve, the Treasury and other governmental and regulatory bodies for the purpose of stabilizing the financial markets will achieve the intended effect, that our business will benefit from these actions or that further government or market developments will not adversely impact us.

In response to the financial issues affecting the banking system and the financial markets and going concern threats to investment banks and other financial institutions, the U.S. Government, the Federal Reserve, the Treasury and other governmental and regulatory bodies have taken action to attempt to stabilize the financial markets.

There can be no assurance that the actions of the U.S. Government will have a beneficial impact on the financial markets, including on current levels of volatility. To the extent the market does not respond favorably to these initiatives or these initiatives do not function as intended, our business may not receive the anticipated positive impact from the legislation. There can also be no assurance that we will be eligible to participate in any programs established by the U.S. Government, or if we are eligible, that we will be able to utilize them successfully or at all. In addition, because the programs are designed, in part, to provide liquidity to restart the market for certain of our targeted assets, the establishment of these programs may result in increased competition for attractive opportunities in our targeted assets. It is also possible that our competitors may utilize the programs which would provide them with attractive debt and equity capital funding from the U.S. Government. In addition, the U.S. Government, the Federal Reserve, the Treasury and other governmental and regulatory bodies have taken or are considering taking other actions to address the financial crisis. We cannot predict whether or when such actions may occur, and such actions could have a dramatic impact on our business, results of operations and financial condition.

We operate in a highly competitive market for investment opportunities and competition may limit our ability to acquire desirable investments in our target assets and could also affect the pricing of these securities.

We operate in a highly competitive market for investment opportunities. Our profitability depends, in large part, on our ability to acquire our target assets at attractive prices. In acquiring our target assets, we will compete with a variety of institutional investors, including other REITs, specialty finance companies, public and private funds (including other funds managed by FIDAC), commercial and investment banks, commercial finance and insurance companies and other financial institutions. Many of our competitors are substantially larger and have considerably greater financial, technical, marketing and other resources than we do. Several other REITs have recently raised, or are expected to raise, significant amounts of capital, and may have investment objectives that overlap with ours, which may create additional competition for investment opportunities. Some competitors may have a lower cost of funds and access to funding sources that may not be available to us, such as funding from the U.S. Government, if we are not eligible to participate in programs established by the U.S. Government. Many of our competitors are not subject to the operating constraints associated with REIT tax compliance or maintenance of an exemption from the Investment Company Act. In addition, some of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider variety of investments and establish more relationships than us. Furthermore, competition for investments in our target assets may lead to the price of such assets increasing, which may further limit our ability to generate desired returns. We cannot assure you that the competitive pressures we face will not have a material adverse effect on our business, financial condition and results of operations. Also, as a result of this competition, desirable investments in our target assets may be limited in the future and we may not be able to take advantage of attractive investment opportunities from time to time, as we can provide no assurance that we will be able to identify and make investments that are consistent with our investment objectives.

Certain actions by the U.S. Federal Reserve could cause a flattening of the yield curve, which could materially adversely affect our business.

In September 2011, the U.S. Federal Reserve announced "Operation Twist," which is a program through which it intends to purchase, by the end of June 2012, $400 billion of U.S. Treasury securities with remaining maturities between six and 30 years and sell an equal amount of U.S. Treasury securities with remaining maturities of three years or less. The effect of Operation Twist could be a flattening in the yield curve, which could result in increased prepayment rates due to lower long-term interest rates and a narrowing of our net interest margin. Please see our risk factor titled "An increase in prepayment rates may adversely affect our profitability." Consequently, Operation Twist and any other future securities purchase programs by the U.S. Federal Reserve could materially adversely affect our business.

The ongoing debt crisis in Europe could have an adverse effect on our business.

During the past several years, several large European banks have experienced financial difficulty and have been either rescued by government assistance or by other large European banks. Several European governments have coordinated plans to attempt to shore up their financial sectors through loans, credit guarantees, capital infusions, promises of continued liquidity funding and interest rate cuts. Additionally, other governments of the world's largest economic countries also implemented interest rate cuts. There is no assurance that these and other plans and programs will be successful in halting the global credit crisis or in preventing other banks from failing. If unsuccessful, this could materially adversely affect our financing and operations as well as those of the entire mortgage sector in general.

As the European credit crisis continues, with the problems in other countries such as Greece, Italy, Spain and Portugal, there is a growing risk to the financial condition and stability of major European banks. Some of these banks or their U.S. banking subsidiaries have provided financing to us, particularly repurchase agreement financing. Recently, many of the U.S. banking subsidiaries of these major European banks were placed on credit watch. If the European credit crisis continues to impact these major European banks, there is the possibility that it will also impact the operations of their U.S. banking subsidiaries. This could adversely affect our financing and operations as well as those of the entire mortgage sector in general. Please also see our risk factor titled "The soundness of other financial institutions could adversely affect us."

Risks Related to Our Business

An increase in the interest payments on our borrowings relative to the interest we earn on our Investment Securities may adversely affect our profitability.

We earn money based upon the spread between the interest payments we earn on our Investment Securities and the interest payments we must make on our borrowings. If the interest payments on our borrowings increase relative to the interest we earn on our Investment Securities, our profitability may be adversely affected. The interest payments on our borrowings may increase relative to the interest we earn on our adjustable-rate interest-earning assets for various reasons discussed in this section.

- Differences in timing of interest rate adjustments on our Investment Securities and our borrowings may adversely affect our profitability

We rely primarily on short-term borrowings to acquire Investment Securities with long-term maturities. Accordingly, if short-term interest rates increase, this may adversely affect our profitability.

Some of the Investment Securities we acquire are adjustable-rate interest-earning assets. This means that their interest rates may vary over time based upon changes in an objective index, such as:

- LIBOR. The interest rate that banks in London offer for deposits in London of U.S. dollars.

- Treasury Rate. A monthly or weekly average yield of benchmark U.S. Treasury securities, as published by the Federal Reserve Board.

These indices generally reflect short-term interest rates. On December 31, 2011, approximately 9% of our Investment Securities were adjustable-rate interest-earning assets.

The interest rates on our borrowings similarly vary with changes in an objective index. Nevertheless, the interest rates on our borrowings generally adjust more frequently than the interest rates on our adjustable-rate interest-earning assets. For example, on December 31, 2011, our adjustable-rate interest-earning assets had a weighted average term to next rate adjustment of 41 months, while our borrowings had a weighted average term of 43 days. Accordingly, in a period of rising interest rates, we could experience a decrease in net income or a net loss because the interest rates on our borrowings adjust faster than the interest rates on our adjustable-rate interest-earning assets.

- Interest rate caps on our Agency mortgage-backed securities and Agency debentures may adversely affect our profitability

Our adjustable-rate interest-earning assets are typically subject to periodic and lifetime interest rate caps. Periodic interest rate caps limit the amount an interest rate can increase during any given period. Lifetime interest rate caps limit the amount an interest rate can increase through maturity of Agency mortgage-backed securities and Agency debentures. Our borrowings are not subject to similar restrictions. Accordingly, in a period of rapidly increasing interest rates, we could experience a decrease in net income or experience a net loss because the interest rates on our borrowings could increase without limitation while the interest rates on our adjustable-rate interest-earning assets would be limited by caps.

- Because we acquire fixed-rate securities, an increase in interest rates may adversely affect our profitability

In a period of rising interest rates, our interest payments could increase while the interest we earn on our fixed-rate mortgage-backed securities would not change. This would adversely affect our profitability. On December 31, 2011, approximately 90% of our Investment Securities were fixed-rate investments.

An increase in prepayment rates may adversely affect our profitability.

The Agency mortgage-backed securities we acquire are backed by pools of mortgage loans. We receive payments, generally, from the payments that are made on these underlying mortgage loans. When borrowers prepay their mortgage loans at rates that are faster-than-expected, this results in prepayments on mortgage-backed securities that are faster than expected. These faster than expected prepayments may adversely affect our profitability. We often purchase mortgage-backed securities that have a higher interest rate than the market interest rate at the time. In exchange for this higher interest rate, we must pay a premium over the market value to acquire the security. In

accordance with accounting rules, we amortize this premium over the term of the mortgage-backed security. If the mortgage-backed security is prepaid in whole or in part prior to its maturity date, however, we must expense all or a part of the remaining unamortized portion of the premium that was prepaid at the time of the prepayment. This adversely affects our profitability.

Prepayment rates generally increase when interest rates fall and decrease when interest rates rise, but changes in prepayment rates are difficult to predict. Prepayment rates also may be affected by conditions in the housing and financial markets, general economic conditions and the relative interest rates on fixed-rate and adjustable-rate mortgage loans.

We often purchase mortgage-backed securities that have a higher coupon rate than the prevailing market interest rates. In exchange for a higher coupon rate, we typically pay a premium over par value to acquire these mortgage-backed securities. In accordance with generally accepted accounting principles (or GAAP), we amortize the premiums on our mortgage-backed securities over the life of the related mortgage-backed securities. If the mortgage loans securing these mortgage-backed securities prepay at a more rapid rate than anticipated, we will have to amortize our premiums on an accelerated basis which may adversely affect our profitability. Defaults on mortgage loans underlying Agency mortgage-backed securities typically have the same effect as prepayments because of the underlying Agency guarantee. Fannie Mae and Freddie Mac significantly increased their purchases of delinquent loans from the pools of mortgages collateralizing their Agency mortgage-backed securities beginning in March 2010. As of December 31, 2011, we had net purchase premiums of $3.3 billion, or 3.4% of current par value, on our Agency mortgage-backed securities, Agency debentures, and corporate debt.

We may seek to reduce prepayment risk by acquiring mortgage-backed securities at a discount. If a discounted security is prepaid in whole or in part prior to its maturity date, we will earn income equal to the amount of the remaining discount. This will improve our profitability if the discounted securities are prepaid faster than expected.

We also can acquire mortgage-backed securities that are less affected by prepayments. For example, we can acquire CMOs, a type of mortgage-backed security. CMOs divide a pool of mortgage loans into multiple tranches that allow for shifting of prepayment risks from slower-paying tranches to faster-paying tranches. This is in contrast to pass-through or pay-through mortgage-backed securities, where all investors share equally in all payments, including all prepayments. As discussed below, the Investment Company Act of 1940 imposes restrictions on our purchase of CMOs. As of December 31, 2011, approximately 17% of our Investment Securities were CMOs and approximately 83% of our Investment Securities were pass-through or pay-through securities.

While we seek to minimize prepayment risk to the extent practical, in selecting investments we must balance prepayment risk against other risks and the potential returns of each investment. No strategy can completely insulate us from prepayment risk.

An increase in interest rates may adversely affect the market value of our investment securities and, therefore, also our book value.

Increases in interest rates may negatively affect the market value of our investment securities because in a period of rising interest rates, the relative value of interest earning assets we own can be expected to fall and reduce the book value. In addition, our fixed-rate securities, generally, are more negatively affected by these increases because in a period of rising interest rates, our interest payments could increase while the interest we earn on our fixed-rate mortgage-backed securities would not change. We reduce our book value by the amount of any decrease in the market value of our investment securities.

Failure to procure funding on favorable terms, or at all, would adversely affect our results and may, in turn, negatively affect the market price of shares of our common stock.

The current dislocation and weakness in the broader mortgage markets could adversely affect one or more of our potential lenders and could cause one or more of our potential lenders to be unwilling or unable to provide us with financing. This could potentially increase our financing costs and reduce our liquidity. If one or more major market

participants fails or otherwise experiences a major liquidity crisis it could negatively impact the marketability of all fixed income securities, including Agency RMBS, and this could negatively impact the value of the securities we acquire, thus reducing our net book value. Furthermore, if any of our potential lenders or any of our lenders are unwilling or unable to provide us with financing, we could be forced to sell our assets at an inopportune time when prices are depressed.

The soundness of other financial institutions could adversely affect us.

Financial services institutions are interrelated as a result of trading, clearing, counterparty, or other relationships. We have exposure to many different industries and counterparties, and routinely execute transactions with counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks, mutual and hedge funds, and other institutional clients. Many of these transactions expose us to credit risk in the event of default of its counterparty or client. There is no assurance that any such losses would not materially and adversely impact our revenues and earnings.

Our strategy involves significant leverage.

We incur this leverage by borrowing against a substantial portion of the market value of our investment securities. By incurring this leverage, we can enhance our returns. Nevertheless, this leverage, which is fundamental to our investment strategy, also creates significant risks.

- Our leverage may cause substantial losses

Because of our significant leverage, we may incur substantial losses if our borrowing costs increase. Our borrowing costs may increase for any of the following reasons:

- short-term interest rates increase;
- the market value of our Investment Securities decreases;
- interest rate volatility increases; or
- the availability of financing in the market decreases.

- Our leverage may cause margin calls and defaults and force us to sell assets under adverse market conditions

Because of our leverage, a decline in the value of our investment securities may result in our lenders initiating margin calls. A margin call means that the lender requires us to pledge additional collateral to re-establish the ratio of the value of the collateral to the amount of the borrowing. Our fixed-rate mortgage-backed securities generally are more susceptible to margin calls as increases in interest rates tend to more negatively affect the market value of fixed-rate securities.

If we are unable to satisfy margin calls, our lenders may foreclose on our collateral. This could force us to sell our investment securities under adverse market conditions. Additionally, in the event of our bankruptcy, our borrowings, which are generally made under repurchase agreements, may qualify for special treatment under the Bankruptcy Code. This special treatment would allow the lenders under these agreements to avoid the automatic stay provisions of the Bankruptcy Code and to liquidate the collateral under these agreements without delay.

- Liquidation of collateral may jeopardize our REIT status

To continue to qualify as a REIT, we must comply with requirements regarding our assets and our sources of income. If we are compelled to liquidate our Agency mortgage-backed securities and Agency debentures, we may be unable to comply with these requirements, ultimately jeopardizing our status as a REIT and our failure to qualify as a REIT will have adverse tax consequences.

- We may exceed our target leverage ratios

We seek to maintain a ratio of debt-to-equity of between 8:1 and 12:1. However, we are not required to stay within this leverage ratio. We may exceed this ratio by incurring additional debt without increasing the amount of equity we have. For example, if we increase the amount of borrowings under our master repurchase agreements with our existing or new counterparties, our leverage ratio would increase. If we increase our debt-to-equity ratio, the adverse impact on our financial condition and results of operations from the types of risks associated with the use of leverage would likely be more severe.

- We may not be able to achieve our optimal leverage

We use leverage as a strategy to increase the return to our investors. However, we may not be able to achieve our desired leverage for any of the following reasons:

- we determine that the leverage would expose us to excessive risk;
- our lenders do not make funding available to us at acceptable rates; or
- our lenders require that we provide additional collateral to cover our borrowings.
- We may incur increased borrowing costs which would adversely affect our profitability

Currently, all of our collateralized borrowings are in the form of repurchase agreements. If the interest rates on these repurchase agreements increase, it would adversely affect our profitability.

Our borrowing costs under repurchase agreements generally correspond to short-term interest rates such as LIBOR or a short-term Treasury index, plus or minus a margin. The margins on these borrowings over or under short-term interest rates may vary depending upon:

- the movement of interest rates;
- the availability of financing in the market; or
- the value and liquidity of our Investment Securities.

If we are unable to renew our borrowings at favorable rates, our profitability may be adversely affected.

Since we rely primarily on short-term borrowings, our ability to achieve our investment objectives depends not only on our ability to borrow money in sufficient amounts and on favorable terms, but also on our ability to renew or replace on a continuous basis our maturing short-term borrowings. If we are not able to renew or replace maturing borrowings, we would have to sell our assets under possibly adverse market conditions.

If a counterparty to our repurchase transactions defaults on its obligation to resell the underlying security back to us at the end of the transaction term, or if the value of the underlying security has declined as of the end of that term, or if we default on our obligations under the repurchase agreement, we will lose money on our repurchase transactions.

When we engage in repurchase transactions, we generally sell securities to lenders (repurchase agreement counterparties) and receive cash from these lenders. The lenders are obligated to resell the same securities back to us at the end of the term of the transaction. Because the cash we receive from the lender when we initially sell the securities to the lender is less than the value of those securities (this difference is the haircut), if the lender defaults on its obligation to resell the same securities back to us, we may incur a loss on the transaction equal to the amount of the haircut (assuming there was no change in the value of the securities). We would also lose money on a repurchase transaction if the value of the underlying securities has declined as of the end of the transaction term, as we would have to repurchase the securities for their initial value but would receive securities worth less than that amount. Further, if we default on one of our obligations under a repurchase transaction, the lender can terminate the transaction and cease entering into any other repurchase transactions with us. Repurchase agreements generally contain cross-default provisions, so that if a default occurs under any one agreement, the lenders under our other agreements could also declare a default. Any losses we incur on our repurchase transactions could adversely affect

our earnings and thus our cash available for distribution to shareholders.

Any repurchase agreements that we use to finance our assets may require us to provide additional collateral or pay down debt.

Our repurchase agreements involve the risk that the market value of the securities pledged or sold by us to the repurchase agreement counterparty may decline in value, in which case the counterparty may require us to provide additional collateral or to repay all or a portion of the funds advanced. We may not have additional collateral or the funds available to repay our debt at that time, which would likely result in defaults unless we are able to raise the funds from alternative sources, which we may not be able to achieve on favorable terms or at all. Posting additional collateral would reduce our liquidity and limit our ability to leverage our assets. If we cannot meet these requirements, the counterparty could accelerate its indebtedness, increase the interest rate on advanced funds and terminate our ability to borrow funds from them, which could materially and adversely affect our financial condition and ability to implement our investment strategy. In addition, in the event that the counterparty files for bankruptcy or becomes insolvent, our securities may become subject to bankruptcy or insolvency proceedings, thus depriving us, at least temporarily, of the benefit of these assets. Such an event could restrict our access to bank credit facilities and increase its cost of capital. Repurchase agreement counterparties may also require us to maintain a certain amount of cash or set aside assets sufficient to maintain a specified liquidity position that would enhance our ability to satisfy its collateral obligations. As a result, we may not be able to leverage our assets as fully as we would choose, which could reduce our return on assets. In the event that we are unable to meet these collateral obligations, our financial condition and prospects could deteriorate rapidly.

Our hedging strategies expose us to risks.

Our policies permit us to enter into interest rate swaps, caps and floors and other derivative transactions to help us mitigate our interest rate and prepayment risks described above. We have used interest rate swaps to provide a level of protection against interest rate risks, but no hedging strategy can protect us completely. Interest rate hedging may fail to protect or could adversely affect us because, among other things: interest rate hedging can be expensive, particularly during periods of rising and volatile interest rates; available interest rate hedges may not correspond directly with the interest rate risk for which protection is sought; and the duration of the hedge may not match the duration of the related liability.

- Our hedging strategies may not be successful in mitigating the risks associated with interest rates

We cannot assure you that our use of derivatives will offset the risks related to changes in interest rates. It is likely that there will be periods in the future during which we will incur losses on our derivative financial instruments that will not be fully offset by gains on our portfolio. The derivative financial instruments we select may not have the effect of reducing our interest rate risk. In addition, the nature and timing of hedging transactions may influence the effectiveness of these strategies. Poorly designed strategies or improperly executed transactions could significantly increase our risk and lead to material losses. In addition, hedging strategies involve transaction and other costs. Our hedging strategy and the derivatives that we use may not adequately offset the risk of interest rate volatility. Moreover, our hedging transactions may result in losses.

- Our use of derivatives may expose us to counterparty risks

We enter into interest rate swap and cap agreements to hedge risks associated with movements in interest rates. If a swap counterparty cannot perform under the terms of an interest rate swap, we would not receive payments due under that agreement, we may lose any unrealized gain associated with the interest rate swap, and the hedged liability would cease to be hedged by the interest rate swap. We may also be at risk for any collateral we have pledged to secure our obligations under the interest rate swap if the counterparty become insolvent or file for bankruptcy. Similarly, if a cap counterparty fails to perform under the terms of the cap agreement, in addition to not receiving payments due under

that agreement that would off-sets our interest expense, we would also incur a loss for all remaining unamortized premium paid for that agreement.

We may face risks of investing in inverse floating rate securities.

We may invest in inverse floaters. The returns on inverse floaters are inversely related to changes in an interest rate. Generally, income on inverse floaters will decrease when interest rates increase and increase when interest rates decrease. Investments in inverse floaters may subject us to the risks of reduced or eliminated interest payments and losses of principal. In addition, certain indexed securities and inverse floaters may increase or decrease in value at a greater rate than the underlying interest rate, which effectively leverages our investment in such securities. As a result, the market value of such securities will generally be more volatile than that of fixed rate securities.

Our investment strategy may involve credit risk.

We may incur losses if there are payment defaults under our Investment Securities.

To date, substantially all of our mortgage-backed securities have been Agency certificates and Agency debentures which, although not rated, carry an implied "AAA" rating. Agency certificates are mortgage pass-through certificates where Freddie Mac, Fannie Mae or Ginnie Mae guarantees payments of principal and interest on the certificates. Agency debentures are debt instruments issued by Freddie Mac, Fannie Mae, or the FHLB.

Even though our Agency mortgage-backed securities and Agency debentures acquired thus far have been "AAA", pursuant to our capital investment policy, we have the ability to acquire securities of lower credit quality. Under our policy:

- 75% of our total assets must be high quality mortgage-backed securities and short-term investments. High quality securities are securities (1) that are rated within one of the two highest rating categories by at least one of the nationally recognized rating agencies, (2) that are unrated but are guaranteed by the United States government or an agency of the United States government, or (3) that are unrated or whose ratings have not been updated but that our management determines are of comparable quality to high quality rated mortgage-backed securities;

- the remaining 25% of total assets, may consist of mortgage-backed securities and other qualified REIT real estate assets which are unrated or rated less than high quality, but which are at least "investment grade" (rated "BBB" or better by Standard & Poor's Corporation (or S&P) or the equivalent by another nationally recognized rating agency) or, if not rated, we determine them to be of comparable credit quality to an investment which is rated "BBB" or better. In addition, we may directly or indirectly invest part of this remaining 25% of our assets in other types of securities, including without limitation, unrated debt, equity or derivative securities, to the extent consistent with our REIT qualification requirements. The derivative securities in which we invest may include securities representing the right to receive interest only or a disproportionately large amount of interest, as well as inverse floaters, which may have imbedded leverage as part of their structural characteristics; and

- we seek to structure our portfolio to maintain a minimum weighted average rating (including our deemed comparable ratings for unrated mortgage-backed securities) of our mortgage-backed securities of at least single "A" under the S&P rating system and at the comparable level under the other rating systems.

If we acquire securities of lower credit quality, we may incur losses if there are defaults under those securities or if the rating agencies downgrade the credit quality of those securities.

We have not established a minimum dividend payment level.

We intend to pay quarterly dividends and to make distributions to our stockholders in amounts such that all or substantially all of our taxable income in each year (subject to certain adjustments) is distributed. This enables us to qualify for the tax benefits accorded to a REIT under the Code. We have not established a minimum dividend payment level and our ability to pay dividends may be adversely affected for the reasons described in this section. All distributions will be made at the discretion of our board of directors and will depend on our earnings, our financial condition, maintenance of our REIT status and such other factors as our board of directors may deem relevant from time to time.

Because of competition, we may not be able to acquire mortgage-backed securities at favorable yields.

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Our net income depends, in large part, on our ability to acquire mortgage-backed securities at favorable spreads over our borrowing costs. In acquiring mortgage-backed securities, we compete with other REITs, investment banking firms, savings and loan associations, banks, insurance companies, mutual funds, other lenders, government entities and other entities that purchase mortgage-backed securities, many of which have greater financial resources than us. As a result, in the future, we may not be able to acquire sufficient mortgage-backed securities at favorable spreads over our borrowing costs.

We are dependent on our key personnel

We are dependent on the efforts of our key officers and employees, including Michael A. J. Farrell, our Chairman of the board of directors, Chief Executive Officer and President, Wellington J. Denahan-Norris, our Vice Chairman, Chief Operating Officer and Chief Investment Officer, and Kathryn F. Fagan, our Chief Financial Officer and Treasurer. The loss of any of their services could have an adverse effect on our operations. Although we have employment agreements with each of them, we cannot assure you they will remain employed with us. We recently announced Mr. Farrell is undergoing chemotherapy for cancer.

Our reported GAAP financial results differ from the taxable income results that impact our dividend distribution requirements and, therefore, our GAAP results may not be an accurate indicator of future taxable income and dividend distributions.

Generally, the cumulative net income we report over the life of an asset will be the same for GAAP and tax purposes, although the timing of this income recognition over the life of the asset could be materially different. Differences exist in the accounting for GAAP net income and REIT taxable income which can lead to significant variances in the amount and timing of when income and losses are recognized under these two measures. Due to these differences, our reported GAAP financial results could materially differ from our determination of taxable income results, which impacts our dividend distribution requirements, and, therefore, our GAAP results may not be an accurate indicator of future taxable income and dividend distributions.

We and our shareholders are subject to certain tax risks

- Our failure to qualify as a REIT would have adverse tax consequences

We believe that since 1997 we have qualified for taxation as a REIT for federal income tax purposes. We plan to continue to meet the requirements for taxation as a REIT. The determination that we are a REIT requires an analysis of various factual matters and circumstances that may not be totally within our control. For example, to qualify as a REIT, at least 75% of our gross income must come from real estate sources and 95% of our gross income must come from real estate sources and certain other sources that are itemized in the REIT tax laws. We are also required to distribute to stockholders at least 90% of our REIT taxable income (determined without regard to the deduction for dividends paid and by excluding any net capital gain). Even a technical or inadvertent mistake could jeopardize our REIT status. Furthermore, Congress and the Internal Revenue Service (or IRS) might make changes to the tax laws and regulations, and the courts might issue new rulings that make it more difficult or impossible for us to remain qualified as a REIT.

If we fail to qualify as a REIT, we would be subject to federal income tax at regular corporate rates. Also, unless the IRS granted us relief under certain statutory provisions, we would remain disqualified as a REIT for four years following the year we first fail to qualify. If we fail to qualify as a REIT, we would have to pay significant income taxes and would therefore have less money available for investments or for distributions to our stockholders. This would likely have a significant adverse effect on the value of our securities. In addition, the tax law would no longer require us to make distributions to our stockholders.

A REIT that fails the quarterly asset tests for one or more quarters will not lose its REIT status as a result of such failure if either (i) the failure is regarded as a de minimis failure under standards set out in the Internal Revenue Code, or (ii) the failure is greater than a de minimis failure but is attributable to reasonable cause and not willful neglect. In the case of a greater than de minimis failure, however, the REIT must pay a tax and must remedy the failure within 6 months of the close of the quarter in which the failure was identified. In addition, the Internal Revenue Code provides relief for failures of other tests imposed as a condition of REIT qualification, as long as the failures are attributable to reasonable cause and not willful neglect. A REIT would be required to pay a penalty of $50,000, however, in the case of each failure.

- We have certain distribution requirements

As a REIT, we must distribute at least 90% of our REIT taxable income (determined without regard to the deduction for dividends paid and by excluding any net capital gain). The required distribution limits the amount we have available for other business purposes, including amounts to fund our growth. Also, it is possible that because of the differences between the time we actually receive revenue or pay expenses and the period we report those items for distribution purposes, we may have to borrow funds on a short-term basis to meet the 90% distribution requirement.

- We are also subject to other tax liabilities

Even if we qualify as a REIT, we may be subject to certain federal, state and local taxes on our income and property. Any of these taxes would reduce our operating cash flow.

- Limits on ownership of our common stock could have adverse consequences to you and could limit your opportunity to receive a premium on our stock

To maintain our qualification as a REIT for federal income tax purposes, not more than 50% in value of the outstanding shares of our capital stock may be owned, directly or indirectly, by five or fewer individuals (as defined in the federal tax laws to include certain entities). Primarily to facilitate maintenance of our qualification as a REIT for federal income tax purposes, our charter will prohibit ownership, directly or by the attribution provisions of the federal tax laws, by any person of more than 9.8% of the lesser of the number or value of the issued and outstanding shares of our common stock and will prohibit ownership, directly or by the attribution provisions of the federal tax laws, by any person of more than 9.8% of the lesser of the number or value of the issued and outstanding shares of any class or series of our preferred stock. Our board of directors, in its sole and absolute discretion, may waive or modify the ownership limit with respect to one or more persons who would not be treated as “individuals” for purposes of the federal tax laws if it is satisfied, based upon information required to be provided by the party seeking the waiver and upon an opinion of counsel satisfactory to the board of directors, that ownership in excess of this limit will not otherwise jeopardize our status as a REIT for federal income tax purposes.

The ownership limit may have the effect of delaying, deferring or preventing a change in control and, therefore, could adversely affect our shareholders’ ability to realize a premium over the then-prevailing market price for our common stock in connection with a change in control.

- A REIT cannot invest more than 25% of its total assets in the stock or securities of one or more taxable REIT subsidiaries; therefore, our taxable subsidiaries cannot constitute more than 25% of our total assets

A taxable REIT subsidiary is a corporation, other than a REIT or a qualified REIT subsidiary, in which a REIT owns stock and which elects taxable REIT subsidiary status. The term also includes a corporate subsidiary in which the taxable REIT subsidiary owns more than a 35% interest. A REIT may own up to 100% of the stock of one or more taxable REIT subsidiaries. A taxable REIT subsidiary may earn income that would not be qualifying income if earned directly by the parent REIT. Overall, at the close of any calendar quarter, no more than 25% of the value of a REIT’s assets may consist of stock or securities of one or more taxable REIT subsidiaries.

The stock and securities of our taxable REIT subsidiaries are expected to represent less than 25% of the value of our total assets. Furthermore, we intend to monitor the value of our investments in the stock and securities of our taxable REIT subsidiaries to ensure compliance with the above-described 25% limitation. We cannot assure you, however, that we will always be able to comply with the 25% limitation so as to maintain REIT status.

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- Taxable REIT subsidiaries are subject to tax at the regular corporate rates, are not required to distribute dividends, and the amount of dividends a taxable REIT subsidiary can pay to its parent REIT may be limited by REIT gross income tests

A taxable REIT subsidiary must pay income tax at regular corporate rates on any income that it earns. Our taxable REIT subsidiaries will pay corporate income tax on their taxable income, and their after-tax net income will be available for distribution to us. Such income, however, is not required to be distributed.

Moreover, the annual gross income tests that must be satisfied to ensure REIT qualification may limit the amount of dividends that we can receive from our taxable REIT subsidiaries and still maintain our REIT status. Generally, not more than 25% of our gross income can be derived from non-real estate related sources, such as dividends from a taxable REIT subsidiary. If, for any taxable year, the dividends we received from our taxable REIT subsidiaries, when added to our other items of non-real estate related income, represented more than 25% of our total gross income for the year, we could be denied REIT status, unless we were able to demonstrate, among other things, that our failure of the gross income test was due to reasonable cause and not willful neglect.

The limitations imposed by the REIT gross income tests may impede our ability to distribute assets from our taxable REIT subsidiaries to us in the form of dividends. Certain asset transfers may, therefore, have to be structured as purchase and sale transactions upon which our taxable REIT subsidiaries recognize taxable gain.

- If interest accrues on indebtedness owed by a taxable REIT subsidiary to its parent REIT at a rate in excess of a commercially reasonable rate, or if transactions between a REIT and a taxable REIT subsidiary are entered into on other than arm's-length terms, the REIT may be subject to a penalty tax

If interest accrues on an indebtedness owed by a taxable REIT subsidiary to its parent REIT at a rate in excess of a commercially reasonable rate, the REIT is subject to tax at a rate of 100% on the excess of (i) interest payments made by a taxable REIT subsidiary to its parent REIT over (ii) the amount of interest that would have been payable had interest accrued on the indebtedness at a commercially reasonable rate. A tax at a rate of 100% is also imposed on any transaction between a taxable REIT subsidiary and its parent REIT to the extent the transaction gives rise to deductions to the taxable REIT subsidiary that are in excess of the deductions that would have been allowable had the transaction been entered into on arm's-length terms. We will scrutinize all of our transactions with our taxable REIT subsidiaries in an effort to ensure that we do not become subject to these taxes. We may not be able to avoid application of these taxes.

Risks of Ownership of Our Common Stock

We may change our policies without stockholder approval.

Our board of directors and management determine all of our policies, including our investment, financing and distribution policies. They may amend or revise these policies at any time without a vote of our stockholders. Policy changes could adversely affect our financial condition, results of operations, the market price of our common stock or our ability to pay dividends or distributions.

Our governing documents and Maryland law impose limitations on the acquisition of our common stock and changes in control that could make it more difficult for a third party to acquire us.

Maryland Business Combination Act

The Maryland General Corporation Law establishes special requirements for "business combinations" between a Maryland corporation and "interested stockholders" unless exemptions are applicable. An interested stockholder is any person who beneficially owns 10% or more of the voting power of our then-outstanding voting stock. Among other things, the law prohibits for a period of five years a merger and other similar transactions between us and an interested stockholder unless the board of directors approved the transaction prior to the party's becoming an interested stockholder. The five-year period runs from the most recent date on which the interested stockholder became an interested stockholder. The law also requires a super majority stockholder vote for such transactions after the end of the five-year period. This means that the transaction must be approved by at least:

- 80% of the votes entitled to be cast by holders of outstanding voting shares; and

- two-thirds of the votes entitled to be cast by holders of outstanding voting shares other than shares held by the interested stockholder or an affiliate of the interested stockholder with whom the business combination is to be effected.

As permitted by the Maryland General Corporation Law, we have elected not to be governed by the Maryland business combination statute. We made this election by opting out of this statute in our articles of incorporation. If, however, we amend our articles of incorporation to opt back in to the statute, the business combination statute could have the effect of discouraging offers to acquire us and of increasing the difficulty of consummating any such offers, even if our acquisition would be in our stockholders' best interests.

Maryland Control Share Acquisition Act

Maryland law provides that "control shares" of a Maryland corporation acquired in a "control share acquisition" have no voting rights except to the extent approved by a vote of the stockholders. Two-thirds of the shares eligible to vote must vote in favor of granting the "control shares" voting rights. "Control shares" are shares of stock that, taken together with all other shares of stock the acquirer previously acquired, would entitle the acquirer to exercise voting power in electing directors within one of the following ranges of voting power:

- one-tenth or more but less than one third of all voting power;

- one-third or more but less than a majority of all voting power; or

- a majority or more of all voting power.

Control shares do not include shares of stock the acquiring person is entitled to vote as a result of having previously obtained stockholder approval. A "control share acquisition" means the acquisition of control shares, subject to certain exceptions.

If a person who has made (or proposes to make) a control share acquisition satisfies certain conditions (including agreeing to pay expenses), he may compel our board of directors to call a special meeting of stockholders to consider the voting rights of the shares. If such a person makes no request for a meeting, we have the option to present the question at any stockholders' meeting.

If voting rights are not approved at a meeting of stockholders then, subject to certain conditions and limitations, we may redeem any or all of the control shares (except those for which voting rights have previously been approved) for fair value. We will determine the fair value of the shares, without regard to voting rights, as of the date of either:

- the last control share acquisition; or

- the meeting where stockholders considered and did not approve voting rights of the control shares.

If voting rights for control shares are approved at a stockholders' meeting and the acquirer becomes entitled to vote a majority of the shares of stock entitled to vote, all other stockholders may obtain rights as objecting stockholders and, thereunder, exercise appraisal rights. This means that you would be able to force us to redeem your stock for fair value. Under Maryland law, the fair value may not be less than the highest price per share paid in the control share acquisition. Furthermore, certain limitations otherwise applicable to the exercise of dissenters' rights would not apply in the context of a control share acquisition. The control share acquisition statute would not apply to shares acquired

in a merger, consolidation or share exchange if we were a party to the transaction. The control share acquisition statute could have the effect of discouraging offers to acquire us and of increasing the difficulty of consummating any such offers, even if our acquisition would be in our stockholders' best interests.

The market price and trading volume of our shares of common stock may be volatile and issuances of large amounts of shares of our common stock could cause the market price of our common stock to decline.

If we issue a significant number of shares of common stock or securities convertible into common stock in a short period of time, there could be a dilution of the existing common stock and a decrease in the market price of the common stock.

The market price of our shares of common stock may be highly volatile and could be subject to wide fluctuations. In addition, the trading volume in our shares of common stock may fluctuate and cause significant price variations to occur. We cannot assure you that the market price of our shares of common stock will not fluctuate or decline significantly in the future. Some of the factors that could negatively affect our share price or result in fluctuations in the price or trading volume of our shares of common stock include those set forth under “Special Note Regarding Forward-Looking Statements” as well as:

- actual or anticipated variations in our quarterly operating results or business prospects;
- changes in our earnings estimates or publication of research reports about us or the real estate industry;
- an inability to meet or exceed securities analysts' estimates or expectations;
- increases in market interest rates;
- hedging or arbitrage trading activity in our shares of common stock;
- capital commitments;
- changes in market valuations of similar companies;
- adverse market reaction to any increased indebtedness we incur in the future;
- additions or departures of management personnel;
- actions by institutional shareholders;
- speculation in the press or investment community;
- changes in our distribution policy;
- general market and economic conditions; and
- future sales of our shares of common stock or securities convertible into, or exchangeable or exercisable for, our shares of common stock.

Holders of our shares of common stock will be subject to the risk of volatile market prices and wide fluctuations in the market price of our shares of common stock. These factors may cause the market price of our shares of common stock to decline, regardless of our financial condition, results of operations, business or prospects. It is impossible to assure you that the market prices of our shares of common stock will not fall in the future.

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There may be future sales or other dilution of our equity, which may adversely affect the market price of our common stock.

On June 23, 2011, our shareholders approved an amendment to our charter to increase the number of authorized shares of capital stock from 1,000,000,000 shares to 2,000,000,000 shares, consisting of 1,987,987,500 shares classified as common stock, 7,412,500 shares classified as 7.875% Series A Cumulative Redeemable Preferred Stock and 4,600,000 shares classified as 6.00% Series B Cumulative Convertible Preferred Stock. The issuance of additional shares of our common stock and in connection with conversions of our outstanding Convertible Senior Notes, or other future issuances convertible securities, including outstanding options and warrants, or otherwise, will dilute the ownership interest of our common stockholders.

Sales of a substantial number of shares of our common stock or other equity-related securities in the public market, or any hedging or arbitrage trading activity that may develop involving our common stock, could depress the market price of our common stock and impair our ability to raise capital through the sale of additional equity securities. We cannot predict the effect that future sales of our common stock or other equity-related securities would have on the market price of our common stock.

The repurchase right in our Convertible Senior Notes triggered by a fundamental change could discourage a potential acquiror.

If we undergo certain fundamental changes, such as the acquisition of 50% of the voting power of all shares of our common equity entitled to vote generally in the election of directors, holders of our Convertible Senior Notes may require us to repurchase all or a portion of their notes at a price equal to 100% of the principal amount of the notes to be purchased plus any accrued and unpaid interest up to, but excluding, the repurchase date. We will pay for all notes so repurchased with shares of our common stock using a price per share equal to the average daily volume-weighted average price of our common stock for the 20 consecutive trading days ending on the trading day immediately prior to the occurrence of the fundamental change. The issuance of these shares of common stock upon certain fundamental changes could discourage a potential acquiror.

Broad market fluctuations could negatively impact the market price of our shares of common stock.

The stock market has experienced extreme price and volume fluctuations that have affected the market price of many companies in industries similar or related to ours and that have been unrelated to these companies' operating performance. These broad market fluctuations could reduce the market price of our shares of common stock. Furthermore, our operating results and prospects may be below the expectations of public market analysts and investors or may be lower than those of companies with comparable market capitalizations, which could lead to a material decline in the market price of our shares of common stock.

Regulatory Risks

Loss of Investment Company Act exemption would adversely affect us.

We intend to conduct our business so as not to become regulated as an investment company under the Investment Company Act of 1940, as amended (the “Investment Company Act”). If we fail to qualify for this exemption, our ability to use leverage would be substantially reduced, and we would be unable to conduct our business as we currently conduct it.

We currently rely on the exemption from registration provided by Section 3(c)(5)(C) of the Investment Company Act. Section 3(c)(5)(C) as interpreted by the staff of the SEC, requires us to invest at least 55% of our assets in

“mortgages and other liens on and interest in real estate” (or Qualifying Real Estate Assets) and at least 80% of our assets in Qualifying Real Estate Assets plus real estate related assets. The assets that we acquire, therefore, are limited by the provisions of the Investment Company Act and the rules and regulations promulgated under the Investment Company Act.

We rely on an interpretation that "whole pool certificates" that are issued or guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae (or Agency Whole Pool Certificates) are Qualifying Real Estate Assets under Section 3(c)(5)(C). This interpretation was promulgated by the SEC staff in a no-action letter over 30 years ago, was reaffirmed by the SEC in 1992 and has been commonly relied on by mortgage REITs.

On August 31, 2011, the SEC issued a concept release titled "Companies Engaged in the Business of Acquiring Mortgages and Mortgage-Related Instruments" (SEC Release No. IC-29778). Under the concept release, the SEC is reviewing interpretive issues related to the Section 3(c)(5)(C) exemption. Among other things, the SEC is requesting comments on whether it should revisit whether Agency Whole Pool Certificates may be treated as interests in real estate (and presumably Qualifying Real Estate Assets) and whether companies, such as us, whose primary business consists of investing in Agency Whole Pool Certificates are the type of entities that Congress intended to be encompassed by the exclusion provided by Section 3(c)(5)(C). The potential outcomes of the SEC's actions are unclear as is the SEC's timetable for its review and actions.

If the SEC determines that any of these securities are not Qualifying Real Estate Assets or real estate related assets, adopts a contrary interpretation with respect to Agency Whole Pool Certificates or otherwise believes we do not satisfy the exemption under Section 3(c)(5)(C), we could be required to restructure our activities or sell certain of our assets. The net effect of these factors will be to lower our net interest income. If we fail to qualify for exemption from registration as an investment company, our ability to use leverage would be substantially reduced, and we would not be able to conduct our business as described. Our business will be materially and adversely affected if we fail to qualify for this exemption.

Compliance with proposed and recently enacted changes in securities laws and regulations increases our costs.

The Sarbanes-Oxley Act of 2002 and rules and regulations promulgated by the SEC and the New York Stock Exchange have increased the scope, complexity and cost of corporate governance, reporting and disclosure practices. We believe that these rules and regulations will make it more costly for us to obtain director and officer liability insurance, and we may be required to accept reduced coverage or incur substantially higher costs to obtain coverage. These rules and regulations could also make it more difficult for us to attract and retain qualified members of management and our board of directors, particularly to serve on our audit committee.

The Dodd-Frank Act contains many regulatory changes and calls for future rulemaking that may affect our business, including, but not limited to resolutions involving derivatives, risk-retention in securitizations and short-term financings. We are evaluating, and will continue to evaluate the potential impact of regulatory change under the Dodd-Frank Act.

Computer malware, viruses, hacking and phishing attacks, and spamming could harm our business and results of operations.

Computer malware, viruses, and computer hacking and phishing attacks have become more prevalent in our industry and may occur on our systems in the future. We rely heavily on our financial, accounting and other data processing systems. Though it is difficult to determine what, if any, harm may directly result from any specific interruption or attack or any failure to maintain performance, reliability and security of our technical infrastructure. As a result any such computer malware, viruses, and computer hacking and phishing attacks may harm our operations.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our executive and administrative office is located at 1211 Avenue of the Americas, Suite 2902 New York, New York 10036, telephone 212-696-0100. This office is leased under a non-cancelable lease expiring December 31, 2015.

ITEM 3. LEGAL PROCEEDINGS

From time to time, we are involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material effect on our consolidated financial statements.

ITEM 4. MINE SAFETY DISCLOSURE

None.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock began trading publicly on October 8, 1997 and is traded on the New York Stock Exchange under the trading symbol "NLY." As of February 13, 2012, we had 970,269,506 shares of common stock issued and outstanding which were held by approximately 718,000 beneficial holders.

The following table sets forth, for the periods indicated, the high, low, and closing sales prices per share of our common stock as reported on the New York Stock Exchange composite tape and the cash dividends declared per share of our common stock.

	Stock Prices		
	High	Low	Close
First Quarter ended March 31, 2011	$18.16	$17.31	$17.45
Second Quarter ended June 30, 2011	$18.79	$17.15	$18.04
Third Quarter ended September 30, 2011	$18.58	$14.05	$16.63
Fourth Quarter ended December 31, 2011	$17.12	$14.65	$15.96
	High	Low	Close
First Quarter ended March 31, 2010	$18.75	$16.96	$17.18
Second Quarter ended June 30, 2010	$18.10	$14.09	$17.15
Third Quarter ended September 30, 2010	$18.54	$16.73	$17.60
Fourth Quarter ended December 31, 2010	$18.37	$17.25	$17.92

	Common Dividends Declared Per Share
First Quarter ended March 31, 2011	$ 0.62
Second Quarter ended June 30, 2011	$ 0.65
Third Quarter ended September 30, 2011	$ 0.60
Fourth Quarter ended December 31, 2011	$ 0.57
First Quarter ended March 31, 2010	$ 0.65
Second Quarter ended June 30, 2010	$ 0.68
Third Quarter ended September 30, 2010	$ 0.68
Fourth Quarter ended December 31, 2010	$ 0.64

We intend to pay quarterly dividends and to distribute to our stockholders all or substantially all of our taxable income in each year (subject to certain adjustments). This will enable us to qualify for the tax benefits accorded to a REIT under the Code. We have not established a minimum dividend payment level and our ability to pay dividends may be adversely affected for the reasons described under the caption "Risk Factors." All distributions will be made at the discretion of our board of directors and will depend on our earnings, our financial condition, maintenance of our REIT status and such other factors as our board of directors may deem relevant from time to time. No dividends can be paid on our common stock unless we have paid full cumulative dividends on our preferred stock. From the date of

issuance of our preferred stock through December 31, 2011, we have paid full cumulative dividends on our preferred stock.

SHARE PERFORMANCE GRAPH

The following graph and table set forth certain information comparing the yearly percentage change in cumulative total return on our common stock to the cumulative total return of the Standard & Poor's Composite 500 stock Index or S&P 500 Index, and the Bloomberg REIT Mortgage Index, or BBG REIT index, an industry index of mortgage REITs. The comparison is for the period from December 31, 2006 to December 31, 2011 and assumes the reinvestment of dividends. The graph and table assume that $100 was invested in our common stock and the two other indices on December 31, 2006. Upon written request we will provide stockholders with a list of the REITs included in the BBG REIT Index.

	12/31/2006	12/31/2007	12/31/2008	12/31/2009	12/31/2010	12/31/2011
Annaly Capital Management, Inc.	100	137	135	163	185	188
S&P 500 Index	100	105	68	84	96	98
BBG Reit Index	100	59	42	48	53	53

The information in the share performance graph and table has been obtained from sources believed to be reliable, but neither its accuracy nor its completeness can be guaranteed. The historical information set forth above is not necessarily indicative of future performance. Accordingly, we do not make or endorse any predictions as to future share performance.

EQUITY COMPENSATION PLAN INFORMATION

On May 27, 2010, at our 2010 Annual Meeting of Stockholders, our stockholders approved the 2010 Equity Incentive Plan. The 2010 Equity Incentive Plan authorizes the Compensation Committee of the board of directors to grant options, stock appreciation rights, dividend equivalent rights, or other share-based award, including restricted shares up to an aggregate of 25,000,000 shares, subject to adjustments as provided in the 2010 Equity Incentive Plan. On June 27, 2011, we granted to each non-management director of the Company options to purchase 1,250 shares of our common stock under the 2010 Equity Incentive Plan. The stock options were issued at the current market price on the date of grant and immediately vested with a contractual term of 5 years. The grant date fair value is calculated using the Black-Scholes option valuation model. For a description of our 2010 Equity Incentive Plan, see Notes to Consolidated Financial Statements.

We had previously adopted a long term stock incentive plan for executive officers, key employees and nonemployee directors (the Incentive Plan). The Incentive Plan authorized, the Compensation Committee of the board of directors to grant awards, including incentive stock options as defined under Section 422 of the Code (ISOs) and options not so qualified (NQSOs). The Incentive Plan authorized the granting of options or other awards for an aggregate of the greater of 500,000 shares or 9.5% of the outstanding shares of our common stock up to a ceiling of 8,932,921 shares. No further awards will be made under the Incentive Plan, although existing awards will remain effective. Stock options were issued at the current market price on the date of grant, subject to an immediate or four year vesting in four equal installments with a contractual term of 5 or 10 years. The grant date fair value is calculated using the Black-Scholes option valuation model. For a description of our Incentive Plan, see Notes to Consolidated Financial Statements.

The following table provides information as of December 31, 2011 concerning shares of our common stock authorized for issuance under the 2010 Incentive Plan and Incentive Plan (the Incentive Plans).

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under the Incentive Plans (excluding previously issued)
Equity compensation plans approved by security holders	6,216,805	$ 15.57	24,775,921
Equity compensation plans not approved by security holders	-	-	-
Total	6,216,805	$ 15.57	24,775,921

ITEM 6. SELECTED FINANCIAL DATA

The following selected financial data are derived from our audited financial statements for the years ended December 31, 2011, 2010, 2009, 2008, and 2007. The selected financial data should be read in conjunction with the more detailed information contained in the Financial Statements and Notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this Form 10-K.

SELECTED FINANCIAL DATA
(dollars in thousands, except for per share data)

	For the Years Ended December 31,				
Statement of Operations Data	2011	2010	2009	2008	2007
Interest income:					
Investments	$3,558,015	$2,676,307	$2,922,499	$3,115,428	$2,355,447
U.S. Treasury Securities	14,706	2,830	-	-	-
Securities loaned	6,897	3,997	103	-	-
Total interest income	3,579,618	2,683,134	2,922,602	3,115,428	2,355,447
Interest expense:					
Repurchase agreements	426,769	397,971	575,867	1,560,976	1,892,372
Convertible Senior Notes	35,017	24,228	-	-	-
U.S. Treasury Securities sold, not yet purchased	13,081	2,649	-	-	-
Securities borrowed	5,459	3,377	92	-	-
Total interest expense	480,326	428,225	575,959	1,560,976	1,892,372
Net interest income	3,099,292	2,254,909	2,346,643	1,554,452	463,075
Other income (loss):					
Investment advisory and other fee income	79,205	58,073	48,952	27,891	22,028
Net gains (losses) on sales of Agency mortgage-backed securities and debentures	206,846	181,791	99,128	10,713	19,062
Dividend income	31,516	31,038	17,184	2,713	91
Net gains (losses) on trading	21,398	(2,351)	-	9,695	19,147
Loss on other-than-temporarily impaired securities	-	-	-	(31,834)	(1,189)
Net unrealized gain (losses) on Agency interest-only mortgage-backed securities	(106,657)	-	-	-	-
Loss on receivable from Prime Broker	-	-	(13,613)	-	-
Income from underwriting	5,618	2,095	-	-	-
Subtotal	237,926	270,646	151,651	19,178	59,139
Gain on termination of interest rate swaps	-	-	-	-	2,096
Realized gains (losses) on interest rate swaps(1)	(882,395)	(735,107)	(719,803)	(327,936)	(34,093)
Unrealized gains (losses) on interest rate swaps	(1,815,107)	(318,832)	349,521	(768,268)	-

Subtotal	(2,697,502)	(1,053,939)	(370,282)	(1,096,204)	(31,997)
Total other income (loss)	(2,459,576)	(783,293)	(218,631)	(1,077,026)	27,142
Expenses:					
Distribution fees	-	360	1,756	1,589	3,647
Compensation expense	206,251	146,958	111,416	87,412	50,798
Other general and administrative expenses	31,093	24,529	18,736	16,210	11,868
Total Expenses	237,344	171,847	131,908	105,211	66,313
Income (loss) before income taxes and income from equity method investment in affiliate	402,372	1,299,769	1,996,104	372,215	423,904
Income taxes	(59,051)	(35,434)	(34,381)	(25,977)	(8,870)
Income (loss) on equity method investment in affiliate	1,140	2,945	(252)	-	-
Income before noncontrolling interest	344,461	1,267,280	1,961,471	346,238	415,034
Noncontrolling interest	-	-	-	58	650
Net income (loss)	344,461	1,267,280	1,961,471	346,180	414,384
Dividends on preferred stock	16,854	18,033	18,501	21,177	21,493
Net income (loss) available (related) to common shareholders	$327,607	$1,249,247	$1,942,970	$325,003	$392,891
Basic net income per average common share	$0.37	$2.12	$3.55	$0.64	$1.32
Diluted net income per average common share	$0.37	$2.04	$3.52	$0.64	$1.31
Other Financial Data					
Total assets	$109,630,002	$83,026,590	$69,376,190	$57,597,615	$53,903,514
6.00% Series B Cumulative Convertible Preferred Stock	$32,272	$40,032	$63,114	$96,042	$111,466
Dividends declared per common share	$2.44	$2.65	$2.54	$2.08	$1.04

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

We own, manage, and finance a portfolio of real estate related assets, including mortgage pass-through certificates, collateralized mortgage obligations (or CMOs), Agency callable debentures, and other securities representing interests in or obligations backed by pools of mortgage loans. Our principal business objective is to generate net income for distribution to our stockholders from the spread between the interest income on our interest-earning assets and the costs of borrowing to finance our acquisition of interest-earning assets and from dividends we receive from our subsidiaries. Our wholly-owned subsidiaries offer diversified real estate, asset management and other financial services. FIDAC and Merganser are our wholly-owned taxable REIT subsidiaries that are registered investment advisors that generate advisory and service fee income. RCap is our wholly-owned broker dealer taxable REIT subsidiary which generates fee income. We also own subsidiaries engaged in corporate middle market lending transactions, providing warehouse financing to residential mortgage originators, providing advice on commercial real estate transactions, including sale-leaseback and single tenant net leased properties across Europe, and investing in trading securities.

We are primarily engaged in the business of investing, on a leveraged basis, in mortgage pass-through certificates, CMOs and other mortgage-backed securities representing interests in or obligations backed by pools of mortgage loans issued or guaranteed by Freddie Mac, Fannie Mae and Ginnie Mae. We also invest in Federal Home Loan Bank (or FHLB), Freddie Mac and Fannie Mae debentures.

Under our capital investment policy, at least 75% of our total assets must be comprised of high-quality mortgage-backed securities and short-term investments. High quality securities means securities that (1) are rated within one of the two highest rating categories by at least one of the nationally recognized rating agencies, (2) are unrated but are guaranteed by the United States government or an agency of the United States government, or (3) are unrated but we determine them to be of comparable quality to high-quality rated mortgage-backed securities.

The remainder of our assets, comprising not more than 25% of our total assets, may consist of other qualified REIT real estate assets which are unrated or rated less than high quality, but which are at least "investment grade" (rated "BBB" or better by Standard & Poor's Corporation (or S&P) or the equivalent by another nationally recognized rating agency) or, if not rated, we determine them to be of comparable credit quality to an investment which is rated "BBB" or better. In addition, we may directly or indirectly invest part of this remaining 25% of our assets in other types of securities, including without limitation, unrated debt, equity or derivative securities, to the extent consistent with our REIT qualification requirements. The derivative securities in which we invest may include securities representing the right to receive interest only or a disproportionately large amount of interest, as well as inverse floaters, which may have imbedded leverage as part of their structural characteristics.

We may acquire Agency mortgage-backed securities backed by single-family residential mortgage loans as well as securities backed by loans on multi-family, commercial or other real estate related properties. To date, substantially all of the Agency mortgage-backed securities that we have acquired have been backed by single-family residential mortgage loans.

We have elected to be taxed as a real-estate investment trust, or REIT, for federal income tax purposes. Pursuant to the current federal tax regulations, one of the requirements of maintaining our status as a REIT is that we must distribute at least 90% of our REIT taxable income (determined without regard to the deduction for dividends paid and by excluding any net capital gain) to our stockholders, subject to certain adjustments.

The results of our operations are affected by various factors, many of which are beyond our control. Our results of operations primarily depend on, among other things, our net interest income, the market value of our assets and the supply of and demand for such assets. Our net interest income, which reflects the amortization of purchase premiums and accretion of discounts, varies primarily as a result of changes in interest rates, borrowing costs and prepayment speeds, the behavior of which involves various risks and uncertainties. Prepayment speeds, as reflected by the Constant Prepayment Rate, (or CPR), and interest rates vary according to the type of investment, conditions in financial markets, competition and other factors, none of which can be predicted with any certainty. In general, as prepayment speeds on our Agency mortgage-backed securities portfolio increase, related purchase premium amortization increases, thereby reducing the net yield on such assets. The CPR on our Agency mortgage-backed securities portfolio averaged 17%, 27%, and 19% for the years ended December 31, 2011, 2010, and 2009, respectively. Since changes in interest rates may significantly affect our activities, our operating results depend, in large part, upon our ability to effectively manage interest rate risks and prepayment risks while maintaining our status as a REIT. We continue to explore alternative business strategies, alternative investments and other strategic initiatives to complement our core business strategy of investing, on a leveraged basis, in high quality Investment Securities. No assurance, however, can be provided that any such strategic initiative will or will not be implemented in the future.

The table below provides quarterly information regarding our average balances, interest income, yield on assets, economic interest expense, average interest-bearing liabilities, cost of interest-bearing liabilities, economic net interest income and net interest rate spreads for the quarterly periods presented.

	Average Interest-Earning Assets(1)	Total Interest Income	Yield on Average Interest-Earning Assets	Average Interest-Bearing Liabilities	Economic Interest Expense (2)	Average Cost of Interest-Bearing Liabilities	Economic Net Interest Income(3)	Net Interest Rate Spread
	(ratios for the quarters have been annualized, dollars in thousands)							
Year Ended December 31, 2011	$96,675,016	$3,579,618	3.70 %	$84,595,933	$1,362,721	1.61 %	$2,216,897	2.09 %
Year Ended December 31, 2010	$66,981,887	$2,683,134	4.01 %	$60,242,842	$1,163,332	1.93 %	$1,519,802	2.08 %
Year Ended December 31, 2009	$58,554,200	$2,922,602	4.99 %	$52,361,607	$1,295,762	2.47 %	$1,626,840	2.52 %
Year Ended December 31, 2008	$55,962,519	$3,115,428	5.57 %	$50,270,226	$1,888,912	3.76 %	$1,226,516	1.81 %
Year Ended December 31, 2007	$40,800,148	$2,355,447	5.77 %	$37,967,215	$1,926,465	5.07 %	$428,982	0.70 %
Quarter Ended December 31, 2011	$102,339,797	$847,700	3.31 %	$89,488,111	$357,771	1.60 %	$489,929	1.71 %
Quarter Ended September 30, 2011	$100,473,505	$930,802	3.71 %	$86,617,908	$353,266	1.63 %	$577,536	2.08 %
Quarter Ended June 30, 2011	$94,696,473	$957,068	4.04 %	$83,042,390	$330,080	1.59 %	$626,988	2.45 %
Quarter Ended March 31, 2011	$89,190,290	$844,048	3.79 %	$79,235,324	$321,604	1.62 %	$522,444	2.17 %

(1) Does not reflect unrealized gains/ (losses) or premium/ (discount).

(2) Economic interest expense includes interest expense on interest rate swaps.

(3) Economic net interest income includes interest expense on interest rate swaps

The following table presents the CPR experienced on our Agency mortgage-backed securities portfolio, on an annualized basis, for the quarterly periods presented.

Quarter Ended	CPR	
December 31, 2011	22	%
September 30, 2011	18	%
June 30, 2011	11	%

March 31, 2011	17	%

For the purpose of calculating average interest-earning assets and interest-bearing liabilities, daily balances are used. For the purposes of computing ratios relating to equity measures, throughout this report, equity includes Series B preferred stock, which has been treated under GAAP as temporary equity. For the purpose of computing net interest income and ratios relating to cost of fund measures throughout this report, interest expense includes interest expense on interest rate swaps, which is classified in the Consolidated Statements of Operations and Comprehensive Income (Loss) as Realized losses on interest rate swaps. Interest rate swaps are used to hedge the increase in interest expense on repurchase agreements in a rising rate environment. Presenting the contractual interest payments on interest rate swaps with the interest expense on interest-bearing liabilities reflects total contractual interest payments. This presentation depicts the economic value of our investment strategy. Interest expense, including interest payments on interest rate swaps, is referred to as economic interest expense. Net interest income, including interest payments on interest rate swaps, is referred to as economic net interest income.

The following table compares the GAAP and non-GAAP measurements reflected in the Management's Discussion and Analysis of Financial Condition and Results of Operations.

	GAAP Total Stockholders' Equity	Non-GAAP Total Stockholders' Equity	GAAP Interest Expense	Economic Interest Expense	GAAP Net Interest Income	Economic Net interest Income
			(dollars in thousands)			
For the Year Ended December 31, 2011	$15,760,642	$15,792,914	$480,326	$1,362,721	$3,099,292	$2,216,897
For the Year Ended December 31, 2010	$9,864,900	$9,904,932	$428,225	$1,163,332	$2,254,909	$1,519,802
For the Year Ended December 31, 2009	$9,554,426	$9,617,540	$575,959	$1,295,762	$2,346,643	$1,626,840
For the Year Ended December 31, 2008	$7,183,272	$7,279,314	$1,560,976	$1,888,912	$1,554,452	$1,226,516
For the Year Ended December 31, 2007	$5,204,938	$5,316,404	$1,892,372	$1,926,465	$463,075	$428,982
For the Quarter Ended December 31, 2011	$15,760,642	$15,792,914	$130,133	$357,771	$717,567	$489,929
For the Quarter Ended September 30, 2011	$15,910,022	$15,943,686	$121,417	$353,266	$809,385	$577,536
For the Quarter Ended June 30, 2011	$13,929,362	$13,969,321	$113,320	$330,080	$843,748	$626,988
For the Quarter Ended March 31, 2011	$12,853,017	$12,893,000	$115,456	$321,604	$728,592	$522,444

Critical Accounting Policies

Our consolidated financial statements are prepared in accordance with GAAP, which require us to make estimates and assumptions (see Note 1 to the consolidated financial statements). We believe that of our significant accounting policies the following involve a higher degree of judgment and complexity.

Valuation of Financial Instruments

Agency mortgage-backed securities and debentures:

There is an active market for Agency mortgage-backed securities and debentures. Since we primarily invest in securities that can be measured from actively quoted prices, there is a high degree of observable inputs and less subjectivity measuring fair value. Internal market values are determined using quoted prices from the TBA market, the Treasury curve, and the underlying characteristics of the individual securities, which may include coupon, periodic and life caps, reset dates, and the expected life of the security. All internal market values are compared to external sources or dealer quotes to determine reasonableness. Additionally, securities used as collateral for repurchase agreements are priced daily by counterparties to ensure sufficient collateralization, providing additional verification of our internal pricing.

Interest rate swaps:

We use the overnight indexed swap ("OIS") curve as an input to value substantially all of our interest rate swaps. We believe using the OIS curve, which reflects the interest rate typically paid on cash collateral, more accurately reflects the fair value of interest rate swaps. Consistent with market practice, we have individually negotiated agreements with certain counterparties to exchange collateral ("margining") based on the level of fair values of the interest rate

swaps. Through this margining process, one party or each party to a derivative contract provides the other party with information about the fair value of the derivative contract to calculate the amount of collateral required, providing additional verification of our recorded fair value of the interest rate swaps.

Revenue Recognition

Interest income on Agency mortgage-backed securities and debentures is recognized over the projected life of the securities using the interest method. The projected life of the securities is determined based on expected prepayment speeds, past prepayment history of the security, government initiatives that would affect the Agency mortgage-backed securities market, and market consensus. Gains or losses on investment securities are recorded on trade date based on the average cost of the security.

Income Taxes

We elected to be taxed as a REIT, under Sections 856 through 860 of the Internal Revenue Code, beginning with our taxable year ended December 31, 1997. To qualify as a REIT, we must meet certain organizational and operational requirements, including a requirement to distribute at least 90% of our ordinary taxable income, if any, to stockholders. As a REIT, we generally will not be subject to U.S. federal income tax on taxable income that we distribute to our stockholders. If we fail to qualify as a REIT in any taxable year, we will then be subject to U.S. federal income taxes on our taxable income at regular corporate rates and we will not be permitted to qualify for treatment as a REIT for U.S. federal income tax purposes for four years following the year during which qualification is lost unless the Internal Revenue Service grants us relief under certain statutory provisions. Such an event could materially adversely affect our net income and net cash available for distributions to stockholders. However, we believe that we will be organized and operate in such a manner as to qualify for treatment as a REIT and we intend to operate in the foreseeable future in such a manner so that we will qualify as a REIT for U.S. federal income tax purposes. We may, however, be subject to certain state and local taxes and our Taxable REIT Subsidiaries are subject to federal, state and local taxes.

Exposure to European financial counterparties

A significant portion of our Agency mortgage-backed securities are financed with repurchase agreements. We secure our borrowings under these agreements by pledging our Agency mortgage-backed securities as collateral to the lender. The collateral we pledge exceeds the amount of the borrowings under each agreement, typically with the extent of over-collateralization being at least 3% of the amount borrowed. If the counterparty to the repurchase agreement defaults on its obligations and we are not able to recover our pledged assets, we are at risk of losing the over-collateralized amount. The amount of this exposure is the difference between the amount loaned to us plus interest due to the counterparty and the fair value of the collateral pledged by us to the lender including accrued interest receivable on such collateral.

We also use interest rate swaps to manage our interest rate risks. Under these swap agreements, we pledge Agency mortgage-backed securities as collateral as part of a margin arrangement for interest rate swaps that are in an unrealized loss position. If a counterparty were to default on its obligation, we would be exposed to a loss to a swap counterparty to the extent that the amount of our Agency mortgage-backed securities pledged exceeded the unrealized loss on the associated swaps and we were not able to recover the excess collateral.

Over the past several years, several large European financial institutions have experienced financial difficulty and have been either rescued by government assistance or by other large European banks or institutions. Some of these financial institutions or their U.S. subsidiaries have provided us financing under repurchase agreements or we have entered into interest rate swaps with such institutions. We have entered into repurchase agreements and/or interest rate swaps with 10 financial institution counterparties that are either domiciled in Europe or a U.S.-based subsidiary of a European domiciled financial institution. The following table summarizes our exposure to such counterparties at December 31, 2011:

Country	Number of Counterparties	Repurchase Agreement Financing	Interest Rate Swaps at Fair Value	Exposure(1)	Exposure as a Percentage of Total Assets
		(dollars in thousands)			
France	3	$ 4,055,883	$ (213,192)	$ 269,821	0.25 %

Germany	1	$	3,337,094	$	(408,372	)	$	237,979	0.22	%
Netherlands	2	$	5,578,511		-		$	340,082	0.31	%
Switzerland	2	$	7,551,660	$	(416,103	)	$	553,525	0.50	%
United Kingdom	2	$	4,706,534	$	(118,123	)	$	256,886	0.23	%
Total	10	$	25,229,682	$	(1,155,790	)	$	1,658,293	1.51	%

(1) Represents the amount of cash and/or securities pledged as collateral to each counterparty less the aggregate of repurchase agreement financing and unrelated loss on swaps for each counterparty.

At December 31, 2011, we did not use credit default swaps or other forms of credit protection to hedge the exposures summarized in the table above.

If the European credit crisis continues to impact these major European financial institutions, it is possible that it will also impact the operations of their U.S. subsidiaries. Our financings and operations could be adversely affected by such events. We monitor our exposure to our repurchase agreement and swap counterparties on a regular basis, using various methods, including review of recent rating agency actions, financial relief plans, credit spreads or other developments and by monitoring the amount of cash and securities collateral pledged and the associated loan amount under repurchase agreements and/or the fair value of swaps with our counterparties. We make reverse margin calls on our counterparties to recover excess collateral as permitted by the agreements governing our financing arrangements or interest rate swaps, or may try to take other actions to reduce the amount of our exposure to a counterparty when necessary.

Results of Operations:

Net Income Summary

For the year ended December 31, 2011 our net income was $344.5 million or $0.37 per average common share, as compared to net income of $1.3 billion or $2.12 per average common share for the year ended December 31, 2010 and net income of $2.0 billion or $3.55 per average common share for the year ended December 31, 2009. Net income per average share decreased by $1.75 per average common share and the total net income decreased $922.8 million for the year ended December 31, 2011, when compared to the year ended December 31, 2010. We attribute the decrease in net income for the year ended December 31, 2011 from the year ended December 31, 2010 to the unrealized losses on interest rate swaps of $1.8 billion for the year ended December 31, 2011, as compared to an unrealized loss on interest rate swaps of $318.8 million for the year ended December 31, 2010.

Net income per average share decreased by $1.43 per average share available to common shareholders and total net income decreased $694.2 million for the year ended December 31, 2010, when compared to the year ended December 31, 2009. We attribute the decrease in total net income for the year ended December 31, 2010 from the year ended December 31, 2009 in part to recording of unrealized loss on interest rate swaps of $318.8 million for the year ended December 31, 2010, compared to an unrealized gain of $349.5 million for the year ended December 31, 2009. Net income for the year ended December 31, 2010, also decreased due to net interest income decreasing by $107.0 million for the year ended December 31, 2010, as compared to the year ended December 31, 2009, due to the decline in the interest rate spread.

Net Income Summary
(dollars in thousands, except for per share data)

	For the Years Ended December 31,		
	2011	2010	2009
Interest income:			
Investments	$3,558,015	$2,676,307	$2,922,499
U.S. Treasury Securities	14,706	2,830	-
Securities loaned	6,897	3,997	103
Total interest income	3,579,618	2,683,134	2,922,602
Interest expense:			
Repurchase agreements	426,769	397,971	575,867
Convertible Senior Notes	35,017	24,228	-
U.S. Treasury Securities sold, not yet purchased	13,081	2,649	-
Securities borrowed	5,459	3,377	92
Total interest expense	480,326	428,225	575,959

Net interest income	3,099,292	2,254,909	2,346,643
Other income (loss):			
Investment advisory and other fee income	79,205	58,073	48,952
Net gains (losses) on sales of Agency mortgage-backed securities and debentures	206,846	181,791	99,128
Dividend income	31,516	31,038	17,184
Net gains (losses) on trading	21,398	(2,351)	-
Net unrealized gain (losses) on Agency interest-only mortgage-backed securities	(106,657)	-	-
Income from underwriting	5,618	2,095	-
Loss on receivable from Prime Broker	-	-	(13,613)
Subtotal	237,926	270,646	151,651
Realized gains (losses) on interest rate swaps(1)	(882,395)	(735,107)	(719,803)
Unrealized gains (losses) on interest rate swaps	(1,815,107)	(318,832)	349,521
Subtotal	(2,697,502)	(1,053,939)	(370,282)
Total other income (loss)	(2,459,576)	(783,293)	(218,631)
Expenses:			
Distribution fees	-	360	1,756
Compensation expense	206,251	146,958	111,416
General and administrative expenses	31,093	24,529	18,736
Total Expenses	237,344	171,847	131,908
Income (loss) before income taxes and income from equity method investment in affiliate	402,372	1,299,769	1,996,104
Income taxes	(59,051)	(35,434)	(34,381)
Income (loss) from equity method investment in affiliate	1,140	2,945	(252)
Net income (loss)	344,461	1,267,280	1,961,471
Dividends on preferred stock	16,854	18,033	18,501
Net income (loss) available (related) to common shareholders	$327,607	$1,249,247	$1,942,970
Weighted average number of basic common shares outstanding	874,212,039	588,192,659	546,973,036
Weighted average number of diluted common shares outstanding	874,518,938	625,307,174	553,130,643
Basic net income per average common share	$0.37	$2.12	$3.55
Diluted net income per average common share	$0.37	$2.04	$3.52
Average total assets	$101,054,583	$76,242,938	$65,224,198
Average equity	$13,700,771	$9,701,233	$8,644,228
Return on average total assets	0.34%	1.66%	3.01%
Return on average equity	2.51%	13.06%	22.69%

(1) Interest expense related to the Company's interest rate swaps is recorded in realized gains (losses) on interest rate swaps on the Consolidated Statements of Operations and Comprehensive Income (Loss)

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Interest Income and Average Earning Asset Yield

Our interest income for the years ended December 31, 2011, 2010, and 2009 was $3.6 billion, $2.7 billion and $2.9 billion, respectively. We had average interest earning assets of $96.7 billion, $67.0 billion and $58.6 billion, and the yield on our average interest earning assets was 3.70%, 4.01%, and 4.99% for the years ended December 31, 2011, 2010 and 2009, respectively. For the year ended December 31, 2011, as compared to the year ended December 31, 2010, interest income increased by $896.5 million, due to the increase in interest earning assets during the year 2011. Our average interest earning assets increased for the year ended December 31, 2011 by $29.7 billion when compared to the year ended December 31, 2010. Interest income decreased by $239.5 million for the year ended December 31, 2010, as compared to the year ended December 31, 2009, due to the decrease in yield on interest earning assets of 98 basis points.

Economic Interest Expense and the Cost of Interest-Bearing Liabilities

Our largest expense is the cost of interest-bearing liabilities. We had average interest-bearing liabilities of $84.6 billion and total economic interest expense of $1.4 billion, which includes $882.4 million in interest expense on interest rate swaps, for the year ended December 31, 2011. We had average interest-bearing liabilities of $60.2 billion and total economic interest expense of $1.2 billion, which includes $735.1 million in interest expense on interest rate swaps, for the year ended December 31, 2010. We had average interest-bearing liabilities of $52.4 billion and total economic interest expense of $1.3 billion, which includes $719.8 million in interest expense on interest rate swaps, for the year ended December 31, 2009. Our average cost of interest-bearing liabilities was 1.61%, 1.93%, 2.47%, including interest expense on interest rate swaps, for the years ended December 31, 2011, 2010, and 2009, respectively. Economic interest expense, including interest expense on interest rate swaps, for the year ended December 31, 2011 increased by $199.4 million when compared to the year ended December 31, 2010, due to the increase in interest-bearing liabilities and the increase in notional amount on interest rate swaps. The cost of interest-bearing liabilities decreased by 32 basis points and the average interest-bearing liabilities increased by $24.4 billion for the year ended December 31, 2011, when compared to the year ended December 31, 2010. Economic interest expense, including interest expense on interest rate swaps, for the year ended December 31, 2010 decreased by $132.4 million when compared to the year ended December 31, 2009, due to the decline in the average cost of interest-bearing liabilities. The cost of interest-bearing liabilities rate decreased by 54 basis points and the average interest-bearing liabilities increased by $7.8 billion for the year ended December 31, 2010 when compared to the year ended December 31, 2009.

The table below shows our average interest-bearing liabilities and average cost of interest-bearing liabilities as compared to average one-month and average six-month LIBOR for the years ended December 31, 2011, 2010, 2009, 2008, and 2007 and the four quarters in 2011.

Average Interest-Bearing Liabilities
(Ratios for the four quarters in 2011 have been annualized, dollars in thousands)

	Average Interest-Bearing Liabilities	Interest-Bearing Liabilities at Period End	Economic Interest Expense(1)	Average Cost of Interest-Bearing Liabilities	Average One-Month LIBOR	Average Six-Month LIBOR	Average One-Month LIBOR Relative to Average Six-Month LIBOR	In O LI
For the Year Ended December 31, 2011	$84,595,933	$86,269,611	$1,362,721	1.61	% 0.23	% 0.51	% (0.28	%) 1.
For the Year Ended December 31, 2010	$60,242,842	$67,260,840	$1,163,332	1.93	% 0.27	% 0.52	% (0.25	%) 1.
For the Year Ended December 31, 2009	$52,361,607	$54,627,186	$1,295,762	2.47	% 0.33	% 1.11	% (0.78	%) 2.
For the Year Ended December 31, 2008	$50,270,226	$46,674,885	$1,888,912	3.76	% 2.68	% 3.06	% (0.38	%) 1.
For the Year Ended December 31, 2007	$37,967,215	$46,079,395	$1,926,465	5.07	% 5.19	% 5.19	% (0.00	%) (0
For the Quarter Ended December 31, 2011	$89,488,111	$86,269,611	$357,771	1.60	% 0.26	% 0.68	% (0.42	%) 1.
For the Quarter Ended September 30, 2011	$86,671,908	$88,509,516	$353,266	1.63	% 0.21	% 0.47	% (0.26	%) 1.
For the Quarter Ended June 30, 2011	$83,042,390	$79,986,235	$330,080	1.59	% 0.20	% 0.42	% (0.22	%) 1.
For the Quarter	$79,235,324	$81,732,664	$321,604	1.62	% 0.26	% 0.46	% (0.20	%) 1.

Ended
March 31,
2011

(1) Economic interest expense includes interest expense on interest rate swaps.

Economic Net Interest Income

Our economic net interest income, including interest expense on interest rate swaps, totaled $2.2 billion, $1.5 billion and $1.6 billion for the years ended December 31, 2011, 2010 and 2009, respectively. Our economic net interest income increased by $697.1 million for the year ended December 31, 2011, as compared to the year ended December 31, 2010 because of the increase in average interest-earnings assets, as a result of raising $5.9 billion in additional capital in 2011. Our economic net interest rate spread for the year ended December 31, 2011 was 2.09%, or 1 basis point more than the interest rate spread for the year ended December 31, 2010 of 2.08%. Our economic net interest income decreased by $107.0 million for the year ended December 31, 2010, as compared to the year ended December 31, 2009 because of the decreased interest rate spread. Our net interest rate spread for the year ended December 31, 2010 was 2.08% or 44 basis points less than the interest rate spread of 2.52% for the year ended December 31, 2009.

The table below shows our economic interest income by average interest earning assets held, total interest income, yield on average interest earning assets, average balance of repurchase agreements, interest expense, average cost of funds, net interest income, and net interest rate spread for the years ended December 31, 2011, 2010, 2009, 2008, and 2007 and the four quarters in 2011.

Economic Net Interest Income
(Ratios for the four quarters in 2011 have been annualized, dollars in thousands)

	Average Interest Earning Assets	Total Interest Income	Yield on Average Interest Earning Assets	Average Interest-Bearing Liabilities	Economic Interest Expense(1)	Average Cost of Interest-Bearing Liabilities	Economic Net Interest Income(1)	Net Interest Rate Spread
For the Year Ended December 31, 2011	$96,675,016	$3,579,618	3.70 %	$84,595,933	$1,362,721	1.61 %	$2,216,897	2.09 %
For the Year Ended December 31, 2010	$66,981,887	$2,683,134	4.01 %	$60,242,842	$1,163,332	1.93 %	$1,519,802	2.08 %
For the Year Ended December 31, 2009	$58,554,200	$2,922,602	4.99 %	$52,361,607	$1,295,762	2.47 %	$1,626,840	2.52 %
For the Year Ended December 31, 2008	$55,962,519	$3,115,428	5.57 %	$50,270,226	$1,888,912	3.76 %	$1,226,516	1.81 %
For the Year Ended December 31, 2007	$40,800,148	$2,355,447	5.77 %	$37,967,215	$1,926,465	5.07 %	$428,982	0.70 %
For the Quarter Ended December 31, 2011	$102,339,797	$847,700	3.31 %	$89,488,111	$357,771	1.60 %	$489,929	1.71 %
For the Quarter Ended September 30, 2011	$100,473,505	$930,802	3.71 %	$86,671,908	$353,266	1.63 %	$577,536	2.08 %
For the Quarter Ended June 30, 2011	$94,696,473	$957,068	4.04 %	$83,042,390	$330,080	1.59 %	$626,988	2.45 %
For the Quarter Ended March 31, 2011	$89,190,290	$844,048	3.79 %	$79,235,324	$321,604	1.62 %	$522,444	2.17 %

(1) Economic interest expense and economic net interest income include interest expense on interest rate swaps.

Investment Advisory and Other Fee Income

FIDAC and Merganser are registered investment advisors specializing in managing fixed income securities. Net investment advisory and fees for the year ended December 31, 2011, 2010, and 2009 totaled $79.2 million, $57.7

million, and $47.2 million, respectively, net of fees paid to third parties pursuant to distribution service agreements for facilitating and promoting distribution of shares or units to FIDAC's clients.

Gains and Losses on Sales of Agency Mortgage-Backed Securities and Agency Debentures

For the year ended December 31, 2011, we disposed of Agency mortgage-backed securities and Agency debentures with a carrying value of $20.1 billion for an aggregate net gain of $206.8 million. For the year ended December 31, 2010, we disposed of Agency mortgage-backed securities and Agency debentures with a carrying value of $10.6 billion for aggregate net gain of $181.8 million. For the year ended December 31, 2009, we disposed of Agency mortgage-backed securities and Agency debentures with a carrying value of $4.6 billion for an aggregate net gain of $99.1 million. We do not expect to sell assets on a frequent basis, but may from time to time sell existing assets to acquire new assets, which our management believes might have higher risk-adjusted returns, or to manage our balance sheet as part of our asset/liability management strategy.

Dividend Income from Available-For-Sale Equity Securities

Dividend income from our investments in Chimera and CreXus, which are managed pursuant to management contracts by our wholly owned subsidiary FIDAC, totaled $31.5 million, $31.0 million, and $17.2 million for the years ended December 31, 2011, 2010 and 2009, respectively.

General and Administrative Expenses

General and administrative (or G&A) expenses were $237.3 million, $171.5 million, and $130.2 million for the years ended December 31, 2011, 2010 and 2009, respectively. G&A expenses as a percentage of average total assets was 0.23%, 0.22%, and 0.20% for the years ended December 31, 2011, 2010, and 2009, respectively. The increase in G&A expenses of $65.8 million for the year December 31, 2011 was primarily the result of increased compensation costs related to us and our subsidiaries. Staff increased from 87 at the end of 2009 to 114 at the end of 2010 and 147 at the end of 2011.

The table below shows our total G&A expenses as compared to average total assets and average equity for the years ended December 31, 2011, 2010, 2009, 2008, and 2007 and the four quarters in 2011.

G&A Expenses and Operating Expense Ratios
(ratios for the quarters have been annualized, dollars in thousands)

	Total G&A Expenses	Total G&A Expenses/Average Assets	Total G&A Expenses/Average Equity
For the Year Ended December 31, 2011	$ 237,344	0.23 %	1.73 %
For the Year Ended December 31, 2010	$ 171,487	0.22 %	1.76 %
For the Year Ended December 31, 2009	$ 130,152	0.20 %	1.51 %
For the Year Ended December 31, 2008	$ 103,622	0.18 %	1.55 %
For the Year Ended December 31, 2007	$ 62,666	0.15 %	1.69 %
For the Quarter Ended December 31, 2011	$ 63,094	0.23 %	1.59 %
For the Quarter Ended September 30, 2011	$ 65,194	0.24 %	1.74 %
For the Quarter Ended June 30, 2011	$ 57,229	0.23 %	1.70 %
For the Quarter Ended March 31, 2011	$ 51,827	0.23 %	1.82 %

Net Income and Return on Average Equity

Our net income was $344.5 million, $1.3 billion and $2.0 billion for the years ended December 31, 2011, 2010 and 2009, respectively. Our return on average equity was 2.51%, 13.06% and 22.69% for the respective years. Net income decreased by $922.8 million for the year ended December 31, 2011, as compared to the year ended December 31, 2010, due to the unrealized loss on interest rate swaps of $1.8 billion for the year ended December 31, 2011, as compared to an unrealized loss on interest rate swaps of $318.8 million for the year ended December 31, 2010. We attribute the decrease in total net income for the year ended December 31, 2010 from the year ended December 31, 2009 primarily due the unrealized loss on interest rate swaps of $318.8 million, as compared to the unrealized gain on interest rate swaps of $349.5 million for the year ended December 31, 2009.

The table below shows the components of our return on average equity for the years ended December 31, 2011, 2010, 2009, 2008, and 2007, and the four quarters in 2011.

Components of Return on Average Equity
(Ratios for the quarters have been annualized)

	Economic Net Interest Income/ Average Equity(1)	Net Investment Advisory and Service Fees/Average Equity	Realized and Unrealized Gains and Losses/Average Equity	Dividend Income from available-for-sale equity securities/ Average Equity	Income from Under-writing/ Average Equity	Income from Equity Investment Method/ Average Equity	G&A Expenses/ Average Equity
For the Year Ended December 31, 2011	16.18 %	0.58 %	(12.36 %)	0.23 %	0.04 %	0.00 %	(1.73 %)
	15.67 %	0.59 %	(1.44 %)	0.32 %	0.02 %	0.03 %	(1.76 %)

For the Year Ended December 31, 2010								
For the Year Ended December 31, 2009	18.82	% 0.55	% 5.03	% 0.20	% -	-	(1.51	%)
For the Year Ended December 31, 2008	18.36	% 0.39	% (11.67	%) 0.04	% -	-	(1.55	%)
For the Year Ended December 31, 2007	11.56	% 0.50	% 1.06	% 0.00	% -	-	(1.69	%)
For the Quarter Ended December 31, 2011	12.35	% 0.52	% 0.18	% 0.21	% 0.00	% 0.00	% (1.59	%)
For the Quarter Ended September 30, 2011	15.45	% 0.56	% (38.81	%) 0.23	% 0.07	% 0.00	% (1.74	%)
For the Quarter Ended June 30, 2011	18.67	% 0.62	% (13.86	%) 0.25	% 0.00	% 0.00	% (1.70	%)
For the Quarter Ended March 31, 2011	18.33	% 0.60	% 7.56	% 0.23	% 0.10	% 0.04	% (1.82	%)

(1) Economic net interest income includes interest expense on interest rate swaps.

Financial Condition

Investment Securities

Substantially all of our Agency mortgage-backed securities at December 31, 2011, 2010, and 2009 were adjustable-rate or fixed-rate mortgage-backed securities backed by single-family mortgage loans. Substantially all of the mortgage assets underlying these mortgage-backed securities were secured with a first lien position on the underlying single-family properties. Substantially all of our mortgage-backed securities were Freddie Mac, Fannie Mae or Ginnie Mae pass through certificates or CMOs, which carry an actual or implied "AAA" rating. All of our Agency debentures are callable and carry an implied "AAA" rating. We carry all of our Agency mortgage-backed securities and Agency debentures at fair value.

We accrete discount balances as an increase in interest income over the expected life of discount on interest earning assets and we amortize premium balances as a decrease in interest income over the expected life of premium on interest earning assets. At December 31, 2011, 2010, and 2009 we had on our balance sheet a total of $27.3 million, $35.6 million and $49.2 million, respectively, of unamortized discount (which is the difference between the remaining principal value and current historical amortized cost of our Investment Securities acquired at a price below principal value) and a total of $3.4 billion, $2.3 billion and $1.3 billion, respectively, of unamortized premium (which is the difference between the remaining principal value and the current historical amortized cost of our Investment Securities acquired at a price above principal value).

We received mortgage principal repayments of $23.6 billion, $29.0 billion and $13.8 billion for the years ended December 31, 2011, 2010 and 2009, respectively. The average prepayment speed for the year ended December 31, 2011, 2010 and 2009 was 17%, 27%, and 19%, respectively. Given our current portfolio composition, if mortgage principal prepayment rates were to increase over the life of our mortgage-backed securities, all other factors being equal, our net interest income would decrease during the life of these mortgage-backed securities as we would be required to amortize our net premium balance into income over a shorter time period. Similarly, if mortgage principal prepayment rates were to decrease over the life of our mortgage-backed securities, all other factors being equal, our net interest income would increase during the life of these mortgage-backed securities as we would amortize our net premium balance over a longer time period.

The table below summarizes certain characteristics of our Agency mortgage-backed securities, Agency debentures and corporate debt at December 31, 2011, 2010, 2009, 2008, and 2007 and September 30, 2011, June 30, 2011, and March 31, 2011.

Agency Mortgage-Backed Securities, Agency Debentures and Corporate Debt
(dollars in thousands)

	Principal Amount	Net Premium	Amortized Cost	Amortized Cost/Principal Amount		Fair Value	Fair Value/Principal Amount		Weighted Average Yield	
At December 31, 2011	$98,904,501	$3,333,416	$102,237,917	103.37	%	$105,192,708	106.35	%	3.22	%
At December 31, 2010	$76,129,522	$2,307,839	$78,437,361	103.03	%	$79,570,274	104.52	%	3.88	%
At December 31, 2009	$62,508,927	$1,247,717	$63,756,644	102.00	%	$65,721,477	105.14	%	4.51	%
At December 31, 2008	$54,508,672	$555,043	$55,063,715	101.02	%	$55,645,940	102.09	%	5.15	%

At December 31, 2007	$52,569,598	$328,376	$52,897,974	100.62	%	$53,133,443	101.07	%	5.75	%
At September 30, 2011	$100,957,108	$3,394,180	$104,351,288	103.36	%	$107,440,790	106.42	%	3.58	%
At June 30, 2011	$92,465,377	$2,986,266	$95,451,643	103.23	%	$97,504,523	105.45	%	3.73	%
At March 31, 2011	$90,209,946	$2,900,102	$93,110,048	103.21	%	$94,080,293	104.29	%	3.96	%

The tables below summarizes certain characteristics of our Agency mortgage-backed securities, Agency debentures and corporate debt at December 31, 2011, 2010, 2009, 2008, and 2007 and September 30, 2011, June 30, 2011, and March 31, 2011. The index level for adjustable-rate Agency mortgage-backed securities, Agency debentures and corporate debt is the weighted average rate of the various short-term interest rate indices, which determine the coupon rate.

Adjustable-Rate Mortgage-Backed Securities, Agency Debentures and Corporate Debt Characteristics
(dollars in thousands)

	Principal Amount	Weighted Average Coupon Rate	Weighted Average Term to Next Adjustment	Weighted Average Lifetime Cap	Weighted Average Asset Yield	Principal Amount at Period End as % of Total Interest-Earning Assets
At December 31, 2011	$ 9,268,113	3.88 %	41 months	9.64 %	2.79 %	9.37 %
At December 31, 2010	$ 11,011,839	4.28 %	39 months	10.16 %	3.04 %	14.46 %
At December 31, 2009	$ 16,196,473	4.55 %	33 months	10.09 %	3.23 %	25.91 %
At December 31, 2008	$ 19,540,152	4.75 %	36 months	10.00 %	3.93 %	35.85 %
At December 31, 2007	$ 15,331,447	5.90 %	39 months	9.89 %	5.63 %	29.16 %
At September 30, 2011	$ 9,917,372	3.85 %	40 months	9.63 %	2.79 %	9.82 %
At June 30, 2011	$ 10,000,985	4.12 %	42 months	10.08 %	3.22 %	10.82 %
At March 31, 2011	$ 10,623,084	4.21 %	39 months	10.09 %	3.02 %	11.78 %

Fixed-Rate Agency Mortgage-Backed Securities, Agency Debentures and Corporate Debt Characteristics
(dollars in thousands)

	Principal Amount	Weighted Average Coupon Rate	Weighted Average Asset Yield	Principal Amount at Period End as % of Total Investment Securities
At December 31, 2011	$ 89,636,388	4.71 %	3.07 %	90.63 %
At December 31, 2010	$ 65,117,683	4.92 %	4.00 %	85.54 %
At December 31, 2009	$ 46,312,455	5.78 %	4.95 %	74.09 %
At December 31, 2008	$ 34,968,520	6.13 %	5.84 %	64.15 %
At December 31, 2007	$ 37,238,151	6.00 %	5.80 %	70.84 %
At December 31, 2007	$ 21,641,549	5.83 %	5.65 %	71.82 %
At September 30, 2011	$ 91,039,736	4.81 %	3.78 %	90.18 %
At June 30, 2011	$ 82,464,392	4.74 %	3.83 %	89.18 %
	$ 79,586,862	4.80 %	4.19 %	88.22 %

At March 31,
2011

At December 31, 2011 and 2010, we held Agency mortgage-backed securities, Agency debentures and corporate debt with coupons linked to various indices. The following tables detail the portfolio characteristics by index.

Adjustable-Rate Agency Mortgage-Backed Securities, Agency Debentures and Corporate Debt by Index
December 31, 2011

	One-Month Libor	Six-Month Libor	Twelve Month Libor	12-Month Moving Average	11th District Cost of Funds	1-Year Treasury Index	Other Indexes(1)
Weighted Average Term to Next Adjustment	1 mo.	7 mo.	52 mo.	4 mo.	4 mo.	31 mo.	31 mo.
Weighted Average Annual Period Cap	6.25%	1.63%	2.00%	0.03%	0.20%	1.88%	0.61%
Weighted Average Lifetime Cap at December 31, 2011	6.84%	11.10%	9.93%	9.46%	10.66%	10.35%	6.87%
Investment Principal Value as Percentage of Investment Securities at December 30, 2011	0.39%	0.44%	6.55%	0.35%	0.30%	0.57%	0.77%

(1) Combination of indices that account for less than 0.05% of total or adjust over time, without a reset index.

Adjustable-Rate Agency Mortgage-Backed Securities, Agency Debentures and Corporate Debt by Index
December 31, 2010

	One-Month Libor	Six-Month Libor	Twelve Month Libor	12-Month Moving Average	11th District Cost of Funds	1-Year Treasury Index	Monthly Federal Cost of Funds	Other Indexes(1)
Weighted Average Term to Next Adjustment	1 mo.	10 mo.	50 mo.	2 mo.	7 mo.	41 mo.	1 mo.	39 mo.
Weighted Average Annual Period Cap	6.41%	1.60%	1.99%	0.03%	0.01%	1.91%	0.00%	9.32%
Weighted Average Lifetime Cap at December 31, 2010	7.03%	11.09%	10.23%	9.46%	10.58%	11.06%	13.43%	15.77%
Investment Principal Value as Percentage of Investment Securities at December 30, 2010	1.28%	0.69%	9.97%	0.59%	0.52%	1.06%	0.06%	0.29%

(1) Combination of indices that account for less than 0.05% of total or adjust over time, without a reset index.

Reverse Repurchase Agreements

At December 31, 2011, RCap and Shannon had outstanding reverse repurchase agreements with non-affiliates of $860.9 million. At December 31, 2010, RCap had outstanding reverse repurchase agreements with non-affiliates of $1.0 billion.

The table below shows the average daily reverse repurchase agreements balance during the years ended December 31, 2011, 2010 and 2009 and the four quarters in 2011.

	Reverse Repurchase Agreements (dollars in thousands)	
	Average Daily Reverse Repurchase Agreements	Reverse Repurchase Agreements at Period End
For the Year Ended December 31, 2011	$ 753,383	$ 860,866
For the Year Ended December 31, 2010	$ 900,994	$ 1,006,163
For the Year Ended December 31, 2009	$ 478,151	$ 757,993
For the Quarter Ended December 31, 2011	$ 370,331	$ 860,866
For the Quarter Ended September 30, 2011	$ 464,101	$ 360,315
For the Quarter Ended June 30, 2011	$ 684,946	$ 593,865
For the Quarter Ended March 31, 2011	$ 1,494,156	$ 1,348,069

Borrowings

As of December 31, 2011 and 2010, 97% of our debt consisted of borrowings collateralized by a pledge of our Investment Securities. These borrowings appear on our balance sheet as repurchase agreements. All of our Agency mortgage-backed securities and debentures are currently accepted as collateral for these borrowings. However, we limit our borrowings, and thus our potential asset growth, in order to maintain unused borrowing capacity and thus increase the liquidity and strength of our balance sheet. For the year ended December 31, 2011, the term to maturity of our borrowings ranged from one day to 7 years. Additionally, we have entered into structured borrowings giving the counterparty the right to call the balance prior to maturity. At December 31, 2011 and December 31, 2010, the weighted average cost of funds for all of our borrowings was 1.60% and 1.84%, respectively, including the effect of the interest rate swaps and Convertible Senior Notes, and the weighted average maturity was 110 days and 127 days, respectively.

During the year ended December 31, 2010, we issued $600.0 million in aggregate principal amount of 4% Convertible Senior Notes due 2015 (or the Convertible Senior Notes) for net proceeds following underwriting expenses of approximately $582.0 million. Interest on the Convertible Senior Notes is paid semi-annually at a rate of 4% per year and the Convertible Senior Notes will mature on February 15, 2015 unless earlier repurchased or converted. The Convertible Senior Notes are convertible into shares of Common Stock at an initial conversion rate and conversion rate at December 31, 2011 of 46.6070 and 62.2331 shares of Common Stock per $1,000 principal amount of Convertible Senior Notes, which was equivalent to an initial conversion price and conversion price at December 31, 2011 of $21.4560 and $16.0686 per share of Common Stock subject to adjustment in certain circumstances.

Liquidity

Liquidity, which is our ability to turn non-cash assets into cash, allows us to purchase additional interest earning assets and to pledge additional assets to secure existing borrowings should the value of our pledged assets decline. Potential immediate sources of liquidity for us include cash balances and unused borrowing capacity. Our non-cash assets are

largely actual or implied AAA assets, and accordingly, we have not had, nor do we anticipate having, difficulty in converting our assets to cash. Our balance sheet also generates liquidity on an on-going basis through mortgage principal repayments and net earnings held prior to payment as dividends. Should our needs ever exceed these on-going sources of liquidity plus the immediate sources of liquidity discussed above, we believe that in most circumstances our interest earning assets could be sold to raise cash. The maintenance of liquidity is one of the goals of our capital investment policy. Under this policy, we limit asset growth in order to preserve unused borrowing capacity for liquidity management purposes.

We anticipate that, upon repayment of each borrowing under a repurchase agreement, we will use the collateral immediately for borrowing under a new repurchase agreement. We have not at the present time entered into any commitment agreements under which the lender would be required to enter into new repurchase agreements during a specified period of time, nor do we presently plan to have liquidity facilities with commercial banks.

Under our repurchase agreements, we may be required to pledge additional assets to our repurchase agreement counterparties (i.e., lenders) in the event the estimated fair value of the existing pledged collateral under such agreements declines and such lenders demand additional collateral (a margin call), which may take the form of additional securities or cash. Similarly, if the estimated fair value of interest earning assets increases due to changes in market interest rates of market factors, lenders may release collateral back to us. Specifically, margin calls result from a decline in the value of our Agency mortgage-backed securities securing our repurchase agreements, prepayments on the mortgages securing such Agency mortgage-backed securities and to changes in the estimated fair value of such Agency mortgage-backed securities generally due to principal reduction of such Agency mortgage-backed securities from scheduled amortization and resulting from changes in market interest rates and other market factors. Through December 31, 2011, we did not have any margin calls on our repurchase agreements that we were not able to satisfy with either cash or additional pledged collateral. However, should prepayment speeds on the mortgages underlying our Agency mortgage-backed securities and/or market interest rates suddenly increase, margin calls on our repurchase agreements could result, causing an adverse change in our liquidity position.

The following table summarizes the effect on our liquidity and cash flows from contractual obligations for repurchase agreements, interest expense on repurchase agreements and Convertible Senior Notes, the non-cancelable office lease and employment agreements at December 31, 2011. The table does not include the effect of net interest rate payments under our interest rate swap agreements. The net swap payments will fluctuate based on monthly changes in the receive rate. At December 31, 2011, the interest rate swaps had a net negative fair value of $2.6 billion.

Contractual Obligations
(dollars in thousands)

	Within One Year	One to Three Years	Three to Five Years	More than Five Years	Total
Repurchase agreements	$80,547,554	$1,650,331	$500,000	$1,400,000	$84,097,885
Interest expense on repurchase agreements, based on rates at December 31, 2011	165,667	177,622	136,307	28,128	507,724
Convertible Senior Notes	-	-	600	-	600
Interest Expense on Convertible Senior Notes	24,000	48,000	3,000	-	75,000
Long-term operating lease obligations	2,682	5,584	381	-	8,647
Employment contracts	93,896	1,146	-	-	95,042
Total	$80,833,799	$1,882,683	$640,288	$1,428,128	$84,784,898

Periodic

In the coming periods, we expect to continue to finance our activities in a manner that is consistent with our current operations via repurchase agreements. During the year ended December 31, 2011, we received $23.6 billion from principal repayments, and used leverage on our Agency mortgage-backed securities which provided $18.6 billion in cash for the year ended December 31, 2011. In addition, we may from time to time sell securities as a source of cash to fund new purchases. During the year ended December 31, 2011, we increased stockholders' equity by $5.9 billion, primarily from cash received from proceeds from follow-on offerings and direct purchases and dividend reinvestment.

Stockholders' Equity

On June 23, 2011, we amended our charter to increase the number of authorized shares of capital stock, par value $0.01 per share, from 1,000,000,000 shares to 2,000,000,000 shares, consisting of 1,987,987,500 shares classified as Common Stock, 7,412,500 shares classified as 7.875% Series A Cumulative Redeemable Preferred Stock, and 4,600,000 shares classified as 6.00% Series B Cumulative Convertible Preferred Stock.

On July 11, 2011 we entered into an agreement pursuant to which we sold 138,000,000 shares of our common stock for net proceeds following expenses of approximately $2.4 billion. This transaction settled on July 15, 2011.

On February 15, 2011 we entered into an agreement pursuant to which we sold 86,250,000 shares of our common stock for net proceeds following expenses of approximately $1.5 billion. This transaction settled on February 18, 2011.

On January 4, 2011 we entered into an agreement pursuant to which we sold 86,250,000 shares of our common stock for net proceeds following expenses of approximately $1.5 billion. This transaction settled on January 7, 2011.

During the year ended December 31, 2011, 679,000 options were exercised under the Long-Term Stock Incentive Plan, or Incentive Plan, for an aggregate exercise price of $9.0 million.

During the year ended December 31, 2011, 320,000 shares of Series B Preferred Stock were converted into 906,000 shares of common stock.

During the year ended December 31, 2011, we raised $455.5 million by issuing 26.2 million shares, through the Direct Purchase and Dividend Reinvestment Program.

On July 13, 2010 we entered into an agreement pursuant to which we sold 60,000,000 shares of our common stock for net proceeds following expenses of approximately $1.0 billion. This transaction settled on July 19, 2010.

During the year ended December 31, 2010, 364,000 options were exercised under the Incentive Plan for an aggregate exercise price of $4.6 million

During the year ended December 31, 2010, 953,000 shares of Series B Preferred Stock were converted into 2.4 million shares of common stock.

During the year ended December 31, 2010, we raised $278.8 million by issuing 15.7 million shares through the Direct Purchase and Dividend Reinvestment Program.

Unrealized Gains and Losses

With our “available-for-sale” accounting treatment, unrealized fluctuations in market values of assets do not impact our GAAP or taxable income but rather are reflected on our balance sheet by changing the carrying value of the asset and stockholders’ equity under “Accumulated Other Comprehensive Income (Loss).” As a result of this mark-to-market accounting treatment, our book value and book value per share are likely to fluctuate far more than if we used historical amortized cost accounting. As a result, comparisons with companies that use historical cost accounting for some or all of their balance sheet may not be meaningful.

The table below shows unrealized gains and losses on the Investment Securities.

Unrealized Gains and Losses
(dollars in thousands)

	2011	2010	2009	2008	2007(1)
Unrealized gain	$ 3,091,152	$ 1,764,182	$ 2,093,709	$ 785,087	$ 379,348
Unrealized loss	(82,164)	(599,540)	(202,392)	(532,857)	(531,545)
Net Unrealized (loss) gain	$ 3,008,988	$ 1,164,642	$ 1,891,317	$ 252,230	$ (152,197)

(1)Includes unrealized gains (loss) on interest rate swaps.

Unrealized changes in the estimated net fair value of available-for-sale investments have one direct effect on our potential earnings and dividends: positive changes increase our equity base and allow us to increase our borrowing capacity while negative changes tend to limit borrowing capacity under our capital investment policy. A very large negative change in the net fair value of our available-for-sale investments securities might impair our liquidity position, requiring us to sell assets with the likely result of realized losses upon sale.

Leverage

Our debt-to-equity ratio at December 31, 2011, 2010 and 2009 was 5.4:1, 6.7:1 and 5.7:1, respectively. We generally expect to maintain a ratio of debt-to-equity of between 8:1 and 12:1, although the ratio may vary, as it currently does because of market conditions, from this range from time to time based upon various factors, including our management's opinion of the level of risk of our assets and liabilities, our liquidity position, our level of unused borrowing capacity and over-collateralization levels required by lenders when we pledge assets to secure borrowings.

Our target debt-to-equity ratio is determined under our capital investment policy. Should our actual debt-to-equity ratio increase above the target level due to asset acquisition or market value fluctuations in assets, we would cease to acquire new assets. Our management will, at that time, present a plan to our board of directors to bring us back to our target debt-to-equity ratio; in many circumstances, this would be accomplished over time by the monthly reduction of the balance of our Agency mortgage-backed securities through principal repayments.

Asset/Liability Management and Effect of Changes in Interest Rates

We continually review our asset/liability management strategy with respect to interest rate risk, mortgage prepayment risk, credit risk and the related issues of capital adequacy and liquidity. Our goal is to provide attractive risk-adjusted stockholder returns while maintaining what we believe is a strong balance sheet.

We seek to manage the extent to which our net income changes as a function of changes in interest rates by matching adjustable-rate assets with variable-rate borrowings. In addition, we have attempted to mitigate the potential impact on net income of periodic and lifetime coupon adjustment restrictions in our portfolio of Agency mortgage-backed securities and Agency debentures by entering into interest rate swaps. At December 31, 2011, we had entered into swap agreements with a total notional amount of $40.1 billion. We agreed to pay a weighted average pay rate of 2.55% and receive a floating rate based on one month LIBOR. At December 31, 2010, we had entered into swap agreements with a total notional amount of $27.1 billion. We agreed to pay a weighted average pay rate of 3.21% and receive a floating rate based on one month LIBOR. We may enter into similar derivative transactions in the future by entering into interest rate collars, caps or floors or purchasing interest only securities.

Changes in interest rates may also affect the rate of mortgage principal prepayments and, as a result, prepayments on mortgage-backed securities. We seek to mitigate the effect of changes in the mortgage principal repayment rate by balancing assets we purchase at a premium with assets we purchase at a discount. To date, the aggregate premium exceeds the aggregate discount on our mortgage-backed securities. As a result, prepayments, which result in the expensing of unamortized premium, will reduce our net income compared to what net income would be absent such prepayments.

Off-Balance Sheet Arrangements

We do not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. Further, we have not guaranteed any obligations of unconsolidated entities nor do we have any commitment or intent to provide funding to any such entities. As such, we are not materially exposed to any market, credit, liquidity or financing risk that could arise if we had engaged in such relationships.

Capital Resources

At December 31, 2011, we had no material commitments for capital expenditures.

Inflation

Virtually all of our assets and liabilities are financial in nature. As a result, interest rates and other factors drive our performance far more than does inflation. Changes in interest rates do not necessarily correlate with inflation rates or changes in inflation rates. Our financial statements are prepared in accordance with GAAP and our dividends are based upon our net income as calculated for tax purposes; in each case, our activities and balance sheet are measured with reference to historical cost or fair market value without considering inflation.

Other Matters

We calculate that at least 75% of our assets were qualified REIT assets, as defined in the Code for the years ended December 31, 2011 and 2010. We also calculate that our revenue qualifies for the 75% source of income test and for the 95% source of income test rules for the years ended December 31, 2011, 2010 and 2009 and for each quarter therein. Consequently, we met the REIT income and asset tests. We also met all REIT requirements regarding the ownership of our common stock and the distribution of our net income. Therefore, for the years ended December 31, 2011, 2010, and 2009, we believe that we qualified as a REIT under the Code.

We at all times intend to conduct our business so as not to become regulated as an investment company under the Investment Company Act of 1940, or the Investment Company Act. If we were to become regulated as an investment company, then our use of leverage would be substantially reduced.

We currently rely on the exemption from registration provided by Section 3(c)(5)(C) of the Investment Company Act. Section 3(c)(5)(C) as interpreted by the staff of the Securities and Exchange Commission (or the SEC), requires us to invest at least 55% of our assets in "mortgages and other liens on and interest in real estate" (or Qualifying Real Estate Assets) and at least 80% of our assets in Qualifying Real Estate Assets plus real estate related assets. The assets that we acquire, therefore, are limited by the provisions of the Investment Company Act and the rules and regulations promulgated under the Investment Company Act.

We rely on an interpretation that "whole pool certificates" that are issued or guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae (or Agency Whole Pool Certificates) are Qualifying Real Estate Assets under Section 3(c)(5)(C). This interpretation was promulgated by the SEC staff in a no-action letter over 30 years ago, was reaffirmed by the SEC in 1992 and has been commonly relied on by mortgage REITs.

On August 31, 2011, the SEC issued a concept release titled "Companies Engaged in the Business of Acquiring Mortgages and Mortgage-Related Instruments" (SEC Release No. IC-29778). Under the concept release, the SEC is reviewing interpretive issues related to the Section 3(c)(5)(C) exemption. Among other things, the SEC specifically is requesting comments on whether it should revisit whether Agency Whole Pool Certificates may be treated as Qualifying Real Estate Assets and whether entities, such as us, whose primary business consists of investing in Agency Whole Pool Certificates are the type of entities that Congress intended to be encompassed by the exclusion provided by Section 3(c)(5)(C). The potential outcomes of the SEC's actions are unclear as is the SEC's timetable for its review and actions.

We determined that as of December 31, 2011 and December 31, 2010, we were in compliance with the exemption from registration provided by Section 3(c)(5)(C) of the Investment Company Act as interpreted by the staff of the SEC.

ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

MARKET RISK

Market risk is the exposure to loss resulting from changes in interest rates, foreign currency exchange rates, commodity prices and equity prices. The primary market risk to which we are exposed is interest rate risk, which is highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors beyond our control. Changes in the general level of interest rates can affect our net interest income, which is the difference between the interest income earned on interest-earning assets and the interest expense incurred in connection with our interest-bearing liabilities, by affecting the spread between our interest-earning assets and interest-bearing liabilities. Changes in the level of interest rates also can affect the value of our Agency mortgage-backed securities and our ability to realize gains from the sale of these assets. We may utilize a variety of financial instruments, including interest rate swaps, caps, floors, inverse floaters and other interest rate exchange contracts, in order to limit the effects of interest rates on our operations. When we use these types of derivatives to hedge the risk of interest-earning assets or interest-bearing liabilities, we may be subject to certain risks, including the risk that losses on a hedge position will reduce the funds available for payments to holders of securities and that the losses may exceed the amount we invested in the instruments.

Our profitability and the value of our portfolio (including interest rate swaps) may be adversely affected during any period as a result of changing interest rates. The following table quantifies the potential changes in economic net interest income and portfolio value, should interest rates go up or down 25, 50 and 75 basis points, assuming the yield curves of the rate shocks will be parallel to each other and the current yield curve. All changes in income and value are measured as percentage changes from the projected net interest income and portfolio value at the base interest rate scenario. The base interest rate scenario assumes interest rates at December 31, 2011 and various estimates regarding prepayment and all activities are made at each level of rate shock. Actual results could differ significantly from these estimates.

Change in Interest Rate	Projected Percentage Change in Economic Net Interest Income(1)	Projected Percentage Change in Portfolio Value, with Effect of Interest Rate Swaps
-75 Basis Points	11.90%	(0.44%)
-50 Basis Points	7.88%	(0.29%)
-25 Basis Points	3.58%	(0.13%)
Base Interest Rate	-	-
+25 Basis Points	(1.87%)	0.10%
+50 Basis Points	(4.89%)	0.15%
+75 Basis Points	(8.47%)	0.12%

(1) Economic net interest income includes interest expense on interest rate swaps.

ASSET AND LIABILITY MANAGEMENT

Asset and liability management is concerned with the timing and magnitude of the repricing of assets and liabilities. We attempt to control risks associated with interest rate movements. Methods for evaluating interest rate risk include an analysis of our interest rate sensitivity "gap," which is the difference between interest-earning assets and interest-bearing liabilities maturing or repricing within a given time period. A gap is considered positive when the amount of interest-rate sensitive assets exceeds the amount of interest-rate sensitive liabilities. A gap is considered negative when the amount of interest-rate sensitive liabilities exceeds interest-rate sensitive assets. During a period of

rising interest rates, a negative gap would tend to adversely affect net interest income, while a positive gap would tend to result in an increase in net interest income. During a period of falling interest rates, a negative gap would tend to result in an increase in net interest income, while a positive gap would tend to affect net interest income adversely. Because different types of assets and liabilities with the same or similar maturities may react differently to changes in overall market rates or conditions, changes in interest rates may affect net interest income positively or negatively even if an institution were perfectly matched in each maturity category.

The following table sets forth the estimated maturity or repricing of our interest-earning assets and interest-bearing liabilities at December 31, 2011. The amounts of assets and liabilities shown within a particular period were determined in accordance with the contractual terms of the assets and liabilities, except adjustable-rate loans, and securities are included in the period in which their interest rates are first scheduled to adjust and not in the period in which they mature and does include the effect of the interest rate swaps. The interest rate sensitivity of our assets and liabilities in the table could vary substantially based on actual prepayment experience.

	Within 3 Months	4-12 Months	More than 1 Year to 3 Years	3 Years and Over	Total
	(dollars in thousands)				
Rate Sensitive Assets:					
Cash equivalents	$994,198	$-	$-	$-	$994,198
Reverse repurchase agreements	860,866	-	-	-	860,866
U.S. Treasury securities	928,547	-	-	-	928,547
Securities borrowed	928,732	-	-	-	928,732
Agency Mortgage-backed securities (principal)	1,073,756	2,549,771	1,169,921	93,169,434	97,962,882
Agency debentures (principal)	-	-	328,375	560,119	888,494
Corporate debt	42,180	10,945	-	-	53,125
Total Rate Sensitive Assets	4,828,279	2,560,716	1,498,296	93,729,553	102,616,844
Rate Sensitive Liabilities:					
U.S. Treasury Securities sold, not yet purchased	826,912	-	-	-	826,912
Repurchase agreements, with the effect of interest rate swaps	33,684,619	10,812,635	10,697,831	28,902,800	84,097,885
Securities loaned	804,901	-	-	-	804,901
Convertible Senior Notes (principal)	-	-	-	600,000	600,000
Total Rate Sensitive Liabilities	35,316,432	10,812,635	10,697,831	29,502,800	86,329,698
Interest rate sensitivity gap	$(30,488,153)	$(8,251,919)	$(9,199,535)	$64,226,753	$16,287,146
Cumulative rate sensitivity gap	$(30,488,153)	$(38,740,072)	$(47,939,607)	$16,287,146	
Cumulative interest rate sensitivity gap as a percentage of total rate-sensitive assets	(30 %)	(38 %)	(47 %)	16 %	

Our analysis of risks is based on management's experience, estimates, models and assumptions. These analyses rely on models which utilize estimates of fair value and interest rate sensitivity. Actual economic conditions or implementation of investment decisions by our management may produce results that differ significantly from the estimates and assumptions used in our models and the projected results shown in the above tables and in this report. These analyses contain certain forward-looking statements and are subject to the safe harbor statement set forth under the heading, "Special Note Regarding Forward-Looking Statements."

ITEM 8 FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our financial statements and the related notes, together with the Report of Independent Registered Public Accounting Firm thereon, are set forth on pages F-1 through F-24 of this Form 10-K.

ITEM 9 CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A CONTROLS AND PROCEDURES

Our management, including our Chief Executive Officer (the CEO) and Chief Financial Officer (the CFO), reviewed and evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) of the Securities Exchange Act) as of the end of the period covered by this annual report. Based on that review and evaluation, the CEO and CFO have concluded that our current disclosure controls and procedures, as designed and implemented, (1) were effective in ensuring that information regarding the Company and its subsidiaries is accumulated and communicated to our management, including our CEO and CFO, by our employees, as appropriate to allow timely decisions regarding required disclosure and (2) were effective in providing reasonable assurance that information the Company must disclose in its periodic reports under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods prescribed by the SEC’s rules and forms.

There have been no changes in the Company's internal controls over financial reporting that occurred during the quarter ended December 31, 2011 that have materially affected, or are reasonably likely to affect its internal control over financial reporting.

Management Report On Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rules 13a-15(f) under the Securities Exchange Act as a process designed by, or under the supervision of, the Company's principal executive and principal financial officers and effected by the Company's board of directors, management and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company;

provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and

provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. As a result, even systems determined to be effective can provide only reasonable assurance regarding the preparation and presentation of financial statements. Moreover, projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

The Company's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2011. In making this assessment, the Company's management used criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (or COSO) in Internal Control-Integrated Framework.

Based on management's assessment, the Company's management believes that, as of December 31, 2011, the Company's internal control over financial reporting was effective based on those criteria. The Company's independent registered public accounting firm, Deloitte & Touche LLP, has issued an attestation report on the Company's internal control over financial reporting. This report appears on page F-1 of this annual report on Form 10-K.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10 DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by Item 10 as to our directors is incorporated herein by reference to the proxy statement to be filed with the SEC within 120 days after December 31, 2011. The information regarding our executive officers required by Item 10 appears in Part I of this Form 10-K. The information required by Item 10 as to our compliance with Section 16(a) of the Securities Exchange Act of 1934 is incorporated by reference to the proxy statement to be filed with the SEC within 120 days after December 31, 2011.

We have adopted a Code of Business Conduct and Ethics within the meaning of Item 406(b) of Regulation S-K. This Code of Business Conduct and Ethics applies to our principal executive officer, principal financial officer and principal accounting officer. This Code of Business Conduct and Ethics is publicly available on our website at www.annaly.com. If we make substantive amendments to this Code of Business Conduct and Ethics or grant any waiver, including any implicit waiver, we intend to disclose these events on our website.

The information regarding certain matters pertaining to our corporate governance required by Item 407(c)(3), (d)(4) and (d)(5) of Regulation S-K is incorporated by reference to the Proxy Statement to be filed with the SEC within 120 days after December 31, 2011.

ITEM 11 EXECUTIVE COMPENSATION

The information required by Item 11 is incorporated herein by reference to the proxy statement to be filed with the SEC within 120 days after December 31, 2011.

ITEM 12 SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by Item 12 is incorporated herein by reference to the proxy statement to be filed with the SEC within 120 days after December 31, 2011.

ITEM 13 CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by Item 13 is incorporated herein by reference to the proxy statement to be filed with the SEC within 120 days after December 31, 2011.

ITEM 14 PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by Item 14 is incorporated herein by reference to the proxy statement to be filed with the SEC within 120 days after December 31, 2011.

PART IV

ITEM 15 EXHIBITS, FINANCIAL STATEMENT SCHEDULES.

(a) Documents filed as part of this report:

1. Financial Statements.

2. Schedules to Financial Statements:

All financial statement schedules not included have been omitted because they are either inapplicable or the information required is provided in our Financial Statements and Notes thereto, included in Part II, Item 8, of this Annual Report on Form 10-K.

3. Exhibits:

EXHIBIT INDEX

Exhibit Number	Exhibit Description
3.1	Articles of Amendment and Restatement of the Articles of Incorporation of the Registrant (incorporated by reference to Exhibit 3.2 to the Registrant's Registration Statement on Form S-11 (Registration No. 333-32913) filed with the Securities and Exchange Commission on August 5, 1997).
3.2	Articles of Amendment of the Articles of Incorporation of the Registrant (incorporated by reference to Exhibit 3.1 of the Registrant's Registration Statement on Form S-3 (Registration Statement 333-74618) filed with the Securities and Exchange Commission on June 12, 2002).
3.3	Articles of Amendment of the Articles of Incorporation of the Registrant (incorporated by reference to Exhibit 3.1 of the Registrant's Form 8-K (filed with the Securities and Exchange Commission on August 3, 2006)).
3.4	Articles of Amendment of the Articles of Incorporation of the Registrant (incorporated by reference to Exhibit 3.4 of the Registrant's Form 10-Q (filed with the Securities and Exchange Commission on May 7, 2008)).
3.5	Articles of Amendment of the Articles of Incorporation of the Registrant (incorporated by reference to Exhibit 3.1 of the Registrant's Form 8-K (filed with the Securities and Exchange Commission on June 23, 2011)).
3.6	Form of Articles Supplementary designating the Registrant's 7.875% Series A Cumulative Redeemable Preferred Stock, liquidation preference $25.00 per share (incorporated by reference to Exhibit 3.3 to the Registrant's 8-A filed April 1, 2004).
3.7	Articles Supplementary of the Registrant's designating an additional 2,750,000 shares of the Company's 7.875% Series A Cumulative Redeemable Preferred Stock, as filed with the State Department of Assessments and Taxation of Maryland on October 15, 2004 (incorporated by reference to Exhibit 3.2 to the Registrant's 8-K filed October 4, 2004).
3.8	Articles Supplementary designating the Registrant's 6% Series B Cumulative Convertible Preferred Stock, liquidation preference $25.00 per share (incorporated by reference to Exhibit 3.1 to the Registrant's 8-K filed April 10, 2006).
3.9	Bylaws of the Registrant, as amended (incorporated by reference to Exhibit 3.1 of the Registrant's form 8-K (filed with the Securities and Exchange Commission on March 22, 2011)).
4.1	Specimen Common Stock Certificate (incorporated by reference to Exhibit 4.1 to Amendment No. 1 to the Registrant's Registration Statement on Form S-11 (Registration No. 333-32913) filed with the Securities and Exchange Commission on September 17, 1997).

4.2	Specimen Preferred Stock Certificate (incorporated by reference to Exhibit 4.2 to the Registrant's Registration Statement on Form S-3 (Registration No. 333-74618) filed with the Securities and Exchange Commission on December 5, 2001).
4.3	Specimen Series A Preferred Stock Certificate (incorporated by reference to Exhibit 4.1 of the Registrant's Registration Statement on Form 8-A filed with the SEC on April 1, 2004).
4.4	Specimen Series B Preferred Stock Certificate (incorporated by reference to Exhibit 4.1 to the Registrant's Form 8-K filed with the Securities and Exchange Commission on April 10, 2006).

4.5	Indenture, dated as of February 12, 2010, between the Registrant and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 4.1 to the Registrant's Form 8-K filed with the Securities and Exchange Commission on February 12, 2010).
4.6	Supplemental Indenture, dated as of February 12, 2010, between the Registrant and Wells Fargo Bank, National Association (incorporated by reference to Exhibit 4.2 to the Registrant's Form 8-K filed with the Securities and Exchange Commission on February 12, 2010).
4.7	Form of 4.00% Convertible Senior Note due 2015 (included in Exhibit 4.6).
10.1	Long-Term Stock Incentive Plan (incorporated by reference to Exhibit 10.3 to the Registrant's Registration Statement on Form S-11 (Registration No. 333-32913) filed with the Securities and Exchange Commission on August 5, 1997).*
10.2	Form of Master Repurchase Agreement (incorporated by reference to Exhibit 10.7 to the Registrant's Registration Statement on Form S-11 (Registration No. 333-32913) filed with the Securities and Exchange Commission on August 5, 1997).
10.3	Amended and Restated Employment Agreement, effective as of June 4, 2004, between the Registrant and Michael A.J. Farrell (incorporated by reference to Exhibit 10.3 of the Registrant's Form 10-K filed with the Securities and Exchange Commission on March 10, 2005).*
10.4	Amended and Restated Employment Agreement, dated as of February 25, 2008, between the Registrant and Wellington J. Denahan (incorporated by reference to Exhibit 10.4 of the Registrant's Form 10-K filed with the Securities and Exchange Commission on February 26, 2008).*
10.5	Amended and Restated Employment Agreement, effective as of June 4, 2004,between the Registrant and Kathryn F. Fagan (incorporated by reference to Exhibit 10.5 of the Registrant's Form 10-K filed with the Securities and Exchange Commission on March 10, 2005).*
10.6	Amended and Restated Employment Agreement, effective as of June 4, 2004, between the Registrant and James P. Fortescue (incorporated by reference to Exhibit 10.7 of the Registrant's Form 10-K filed with the Securities and Exchange Commission on March 10, 2005).*
10.7	Amended and Restated Employment Agreement, dated as of January 23, 2006, between the Registrant and Jeremy Diamond (incorporated by reference to Exhibit 10.7 of the Registrant's Form 10-K filed with the Securities and Exchange Commission on March 13, 2006).*
10.8	Amended and Restated Employment Agreement, dated as of January 23, 2006, between the Registrant and Ronald D. Kazel (incorporated by reference to Exhibit 10.7 of the Registrant's Form 10-K filed with the Securities and Exchange Commission on March 13, 2006).*
10.9	Amended and Restated Employment Agreement, dated as of April 21, 2006, between the Registrant and Rose-Marie Lyght (incorporated by reference to Exhibit 10.9 of the Registrant's Form 10-Q filed with the Securities and Exchange Commission on May 9, 2006).*
10.10	Amended and Restated Employment Agreement, effective as of June 4, 2004, between the Registrant and Kristopher R. Konrad (incorporated by reference to Exhibit 10.11 of the Registrant's Form 10-K filed with the Securities and Exchange Commission on March 10, 2005).*
10.11	Amended and Restated Employment Agreement, dated January 23, 2006, between the Registrant and R. Nicholas Singh (incorporated by reference to Exhibit 10.7 of the Registrant's Form 10-K filed with the Securities and Exchange Commission on March 13, 2006).*
10.12	Amended and Restated Employment Agreement, dated August 4, 2010, between the Registrant and Matthew Lambiase (incorporated by reference to Exhibit 10.1 of the Registrant's Form 10-Q filed with the Securities and Exchange Commission August 6, 2010).*
10.13	Employment Agreement, dated July 1, 2010, between the Registrant and Kevin Keyes.*
10.14	Registrant's 2010 Equity Incentive Plan (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report Form 8-K filed with the SEC on June 1, 2010).*
12.1	Computation of ratio of earnings to combined fixed charges and preferred stock dividends and ratio of earnings to fixed charges.

21.1 Subsidiaries of Registrant.
23.1 Consent of Independent Registered Public Accounting Firm.
31.1 Certification of Michael A.J. Farrell, Chairman, Chief Executive Officer, and President of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Kathryn F. Fagan, Chief Financial Officer and Treasurer of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1 Certification of Michael A.J. Farrell, Chairman, Chief Executive Officer, and President of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2 Certification of Kathryn F. Fagan, Chief Financial Officer and Treasurer of the Registrant, pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Exhibit 101.INS XBRLInstance Document †
Exhibit 101.SCH Taxonomy Extension Schema Document †
XBRL
Exhibit 101.CAL Taxonomy Extension Calculation Linkbase Document †
XBRL
Exhibit 101.DEF Additional Taxonomy Extension Definition Linkbase Document Created†
XBRL
Exhibit 101.LAB Taxonomy Extension Label Linkbase Document †
XBRL
Exhibit 101.PRE Taxonomy Extension Presentation Linkbase Document †
XBRL

* Exhibit Numbers 10.1 and 10.3-10.14 are management contracts or compensatory plans required to be filed as Exhibits to this Form 10-K.

† Submitted electronically herewith. Attached as Exhibit 101 to this report are the following documents formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Statements of Financial Condition at December 31, 2011 and December 31, 2010; (ii) Consolidated Statements of Operations and Comprehensive Income (Loss) for the years ended December 31, 2011, 2010 and 2009; (iii) Consolidated Statement of Stockholders' Equity for the years ended December 31, 2011, 2010 and 2009; (iv) Consolidated Statements of Cash Flows for the years ended December 31, 2011, 2010 and 2009; and (v) Notes to Consolidated Financial Statements. Users of this data are advised pursuant to Rule 406T of Regulation S-T that this interactive data file is deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities and Exchange Act of 1934, and otherwise is not subject to liability under these sections.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES

FINANCIAL STATEMENTS

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
Annaly Capital Management, Inc. and Subsidiaries
New York, New York

We have audited the accompanying consolidated statements of financial condition of Annaly Capital Management, Inc. and Subsidiaries (the "Company") as of December 31, 2011 and 2010, and the related consolidated statements of operations and comprehensive income (loss), stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2011. We also have audited the Company's internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management Report On Internal Control Over Financial Reporting at Item 9A. Our responsibility is to express an opinion on these consolidated financial statements and an opinion on the Company's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Annaly Capital Management, Inc. and Subsidiaries as of December 31, 2011 and 2010, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2011, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on the criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

/s/ Deloitte & Touche LLP
New York, New York
February 28, 2012

Part I
Item1. Financial Statements

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
DECEMBER 31, 2011 AND 2010
(dollars in thousands, except per share amounts)

	December 31, 2011	December 31, 2010
ASSETS		
Cash and cash equivalents	$ 994,198	$ 282,626
Reverse repurchase agreements	860,866	1,006,163
Investments, at fair value:		
U.S. Treasury Securities (including pledged assets of $352,820 and $660,823, respectively)	928,547	1,100,447
Securities borrowed	928,732	216,676
Agency mortgage-backed securities (including pledged assets of $90,406,535 and $67,787,023, respectively)	104,251,055	78,440,330
Agency debentures (including pledged assets of $567,383 and $1,068,869, respectively)	889,580	1,108,261
Investments in affiliates	211,970	252,863
Equity securities	3,891	-
Corporate debt, held for investment	52,073	21,683
Receivable for investments sold	-	151,460
Accrued interest and dividends receivable	409,023	345,250
Receivable from Prime Broker	3,272	3,272
Receivable for advisory and service fees (including from affiliates of $16,245 and $13,020, respectively)	19,550	16,172
Intangible for customer relationships, (net of accumulated amortization of $5,432 million and $9,833, respectively)	10,807	9,290
Goodwill	42,030	42,030
Interest rate swaps, at fair value	-	2,561
Other derivative contracts, at fair value	113	2,607
Other assets	24,295	24,899
Total assets	$ 109,630,002	$ 83,026,590
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
U.S. Treasury Securities sold, not yet purchased, at fair value	$ 826,912	$ 909,462
Repurchase agreements	84,097,885	65,533,537
Securities loaned, at fair value	804,901	217,841
Payable for investments purchased	4,315,796	4,575,026
Convertible Senior Notes	539,913	600,000

Accrued interest payable	138,965	115,766
Dividends payable	552,806	404,220
Interest rate swaps, at fair value	2,552,687	754,439
Other derivative contracts, at fair value	-	2,446
Accounts payable and other liabilities	7,223	8,921
Total liabilities	93,837,088	73,121,658
6.00% Series B Cumulative Convertible Preferred Stock:		
4,600,000 shares authorized, 1,331,849 and 1,652,047 shares issued and outstanding, respectively	32,272	40,032
Stockholders' Equity:		
7.875% Series A Cumulative Redeemable Preferred Stock: 7,412,500 authorized, issued and outstanding	177,088	177,088
Common stock, par value $0.01 per share, 1,987,987,500 authorized, 970,161,647 and 631,594,205 issued and outstanding, respectively	9,702	6,316
Additional paid-in capital	15,068,870	9,175,245
Accumulated other comprehensive income (loss)	3,008,988	1,164,642
Accumulated deficit	(2,504,006)	(658,391)
Total stockholders' equity	15,760,642	9,864,900
Total liabilities, Series B Cumulative Convertible Preferred Stock and stockholders' equity	$ 109,630,002	$ 83,026,590

See notes to consolidated financial statements.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)
YEARS ENDED DECEMBER 31, 2011, 2010, AND 2009
(dollars in thousands, except per share amounts)

	For the Years ended December 31,		
	2011	2010	2009
Interest income:			
Investment securities	$3,558,015	$2,676,307	$ 2,922,499
U.S. Treasury Securities	14,706	2,830	-
Securities loaned	6,897	3,997	103
Total interest income	3,579,618	2,683,134	2,922,602
Interest expense:			
Repurchase agreements	426,769	397,971	575,867
Convertible Senior Notes	35,017	24,228	-
U.S. Treasury Securities sold, not yet purchased	13,081	2,649	-
Securities borrowed	5,459	3,377	92
Total interest expense	480,326	428,225	575,959
Net interest income	3,099,292	2,254,909	2,346,643
Other income (loss):			
Investment advisory and other fee income	79,205	58,073	48,952
Net gains (losses) on sales of Agency mortgage-backed securities and debentures	206,846	181,791	99,128
Dividend income from affiliates	31,516	31,038	17,184
Net gains (losses) on trading assets	21,398	(2,351)	-
Net unrealized gains (losses) on interest-only Agency mortgage-backed securities	(106,657)	-	-
Income from underwriting	5,618	2,095	-
Loss on receivable from Prime Broker	-	-	(13,613)
Subtotal	237,926	270,646	151,651
Realized gains (losses) on interest rate swaps(1)	(882,395)	(735,107)	(719,803)
Unrealized gains (losses) on interest rate swaps	(1,815,107)	(318,832)	349,521
Subtotal	(2,697,502)	(1,053,939)	(370,282)
Total other income (loss)	(2,459,576)	(783,293)	(218,631)
Expenses:			
Distribution fees	-	360	1,756
Compensation expense	206,251	146,958	111,416
Other general and administrative expenses	31,093	24,529	18,736
Total Expenses	237,344	171,847	131,908
Income before income taxes and income (loss) on equity method investment	402,372	1,299,769	1,996,104
Income taxes	(59,051)	(35,434)	(34,381)
Income (loss) on equity method investment	1,140	2,945	(252)

Net income	344,461	1,267,280	1,961,471
Dividends on preferred stock	16,854	18,033	18,501
Net income (loss) available (related) to common shareholders	$327,607	$1,249,247	$ 1,942,970
Net income (loss) per share available (related) to common shareholders:			
Basic	$0.37	$2.12	$ 3.55
Diluted	$0.37	$2.04	$ 3.52
Weighted average number of common shares outstanding:			
Basic	874,212,039	588,192,659	546,973,036
Diluted	874,518,938	625,307,174	553,130,643
Net income (loss)	$344,461	$1,267,280	$ 1,961,471
Other comprehensive income (loss):			
Unrealized gains (losses) on available-for-sale securities	2,036,894	(639,783)	1,513,397
Unrealized loss on interest rate swaps	14,298	94,899	224,818
Reclassification adjustment for net (gains) losses included in net income (loss)	$(206,846)	$(181,791)	$ (99,128)
Other comprehensive income (loss)	$1,844,346	$(726,675)	$ 1,639,087
Comprehensive income (loss)	$2,188,807	$540,605	$ 3,600,558

1) (Interest expense related to the Company’s interest rate swaps is recorded in Realized losses on interest rate swaps on the Consolidated Statements of Operations and Comprehensive Income (Loss).

See notes to consolidated financial statements.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2011, 2010, AND 2009
(dollars in thousands, except per share data)

	Preferred Stock	Common Stock Par Value	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total
BALANCE, DECEMBER 31, 2008	$ 177,088	$ 5,415	$ 7,633,438	$ 252,230	$ (884,899)	$ 7,183,272
Net income	-	-	-	-	1,961,471	1,961,471
Other comprehensive income	-	-	-	1,639,087	-	1,639,087
Exercise of stock options	-	4	4,911	-	-	4,915
Stock option expense and long-term compensation expense	-	-	4,514	-	-	4,514
Conversion of Series B cumulative convertible preferred Stock	-	28	32,900	-	-	32,928
Net proceeds from direct purchase and dividend reinvestment	-	84	141,691	-	-	141,775
Preferred Series A dividends declared $1.97 per share	-	-	-	-	(14,593)	(14,593)
Preferred Series B dividends declared $1.50 per share	-	-	-	-	(3,908)	(3,908)
Common dividends declared, $2.54 per share	-	-	-	-	(1,395,035)	(1,395,035)
BALANCE, DECEMBER 31, 2009	$ 177,088	$ 5,531	$ 7,817,454	$ 1,891,317	$ (336,964)	$ 9,554,426
Net income	-	-	-	-	1,267,280	1,267,280
Other comprehensive income	-	-	-	(726,675)	-	(726,675)
Exercise of stock options	-	4	4,596	-	-	4,600
Stock option expense and long-term compensation expense	-	-	4,757	-	-	4,757
Conversion of Series B cumulative convertible preferred Stock	-	24	23,057	-	-	23,081
Net proceeds from direct purchase and dividend reinvestment	-	157	278,626	-	-	278,783
	-	600	1,046,755	-	-	1,047,355

Net proceeds from follow-on offering						
Preferred Series A dividends declared $1.97 per share	-	-	-	-	(14,593)	(14,593)
Preferred Series B dividends declared $1.50 per share	-	-	-	-	(3,440)	(3,440)
Common dividends declared, $2.65 per share	-	-	-	-	(1,570,674)	(1,570,674)
BALANCE, DECEMBER 31, 2010	$ 177,088	$ 6,316	$ 9,175,245	$ 1,164,642	$ (658,391)	$ 9,864,900
Net income	-	-	-	-	344,461	344,461
Other comprehensive income	-	-	-	1,844,346	-	1,844,346
Exercise of stock options	-	7	8,946	-	-	8,953
Stock option expense and long-term compensation expense	-	3	5,266	-	-	5,269
Conversion of Series B cumulative convertible Preferred Stock	-	9	7,750	-	-	7,759
Net proceeds from direct purchase and dividend reinvestment	-	262	455,285	-	-	455,547
Net proceeds from follow-on offering	-	3,105	5,348,741	-	-	5,351,846
Contingent beneficial conversion feature on Convertible Senior Notes	-	-	67,637	-	-	67,637
Preferred Series A dividends declared $1.97 per share	-	-	-	-	(14,593)	(14,593)
Preferred Series B dividends declared $1.50 per share	-	-	-	-	(2,261)	(2,261)
Common dividends declared, $2.44 per share	-	-	-	-	(2,173,222)	(2,173,222)
BALANCE, DECEMBER 31, 2011	$ 177,088	$ 9,702	$ 15,068,870	$ 3,008,988	$ (2,504,006)	$ 15,760,642

See notes to consolidated financial statements.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2011, 2010, AND 2009
(dollars in thousands)

	For the Years Ended December 31,		
	2011	2010	2009
Cash flows from operating activities:			
Net income (loss)	$344,461	$1,267,280	$1,961,471
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Amortization of Investment premiums and discounts, net	794,205	664,429	253,683
Amortization of intangibles	2,300	1,600	2,316
Amortization of deferred expenses	3,600	3,150	-
Amortization of contingent beneficial conversion feature on convertible senior notes	7,550	-	-
(Gains) losses on sales of Agency mortgage-backed securities and debentures	(206,846)	(181,791)	(99,128)
Stock option and long-term compensation expense	5,269	4,757	4,514
Unrealized (gains) losses on equity securities	100	-	-
Unrealized (gains) losses on interest rate swaps	1,815,107	318,832	(349,521)
Unrealized (gains) losses on interest-only Agency mortgage-backed securities	106,657	-	-
Net (gains) losses on trading assets	(21,398)	2,351	-
(Gain) loss on investment with affiliate, equity method	(98)	(318)	252
Proceeds from repurchase agreements from Broker Dealer	877,734,065	1,268,429,168	301,505,728
Payments on repurchase agreements from Broker Dealer	(878,806,056)	(1,258,941,064)	(291,820,728)
Proceeds from reverse repurchase agreements to Broker Dealer	156,659,365	87,968,002	3,100,827
Payments on reverse repurchase agreements to Broker Dealer	(156,502,577)	(88,479,412)	(3,595,580)
Proceeds from reverse repurchase agreements to Shannon	166,354	-	-
Payments on reverse repurchase agreements to Shannon	(177,845)	-	-
Proceeds from securities borrowed	27,261,366	2,924,082	152,027
Payments on securities borrowed	(27,973,422)	(3,111,681)	(181,104)
Proceeds from securities loaned	54,126,121	3,231,198	197,100
Payments on securities loaned	(53,539,061)	(3,042,414)	(168,043)
Proceeds from U.S. Treasury Securities	29,168,074	9,331,089	-
Payments on U.S. Treasury Securities	(28,490,573)	(9,521,134)	-
Net payments on derivatives	(7,158)	(3,455)	-
Net change in:			
Other assets	(3,258)	3,950	(8,780)
Accrued interest and dividends receivable	(64,362)	(27,125)	(35,574)
Receivable for advisory and service fees	(3,378)	(3,606)	(6,462)
Receivable from Prime Broker	-	-	13,613
Accrued interest payable	23,199	26,306	(110,524)
Accounts payable and other liabilities	(1,698)	(1,084)	1,624
Net cash provided by (used in) operating activities	2,420,063	10,863,110	10,817,711
Cash flows from investing activities:			
Payments on purchases of Agency mortgage-backed securities and debentures	(69,065,069)	(54,424,951)	(25,911,199)

Proceeds from sales of Agency mortgage-backed securities and debentures	19,337,053	9,262,772	4,029,801
Principal payments on Agency mortgage-backed securities	23,565,709	28,961,203	13,796,269
Proceeds from Agency debentures called	1,124,000	2,132,002	602,000
Payments on purchase of corporate debt	(31,675)	(21,670)	-
Principal payments on corporate debt	1,375	-	-
Net gains (losses) on other derivative securities	13,965	-	-
Purchase of investment in affiliate	(57,500)	-	(157,995)
Purchase of customer relationships	(3,555)	-	-
Purchase of equity securities	(3,990)	-	-
Proceeds from reverse repurchase agreements	-	4,291,430	10,355,095
Payments on reverse repurchase agreements	-	(4,032,426)	(10,051,980)
Earn out payment	-	(14,113)	-
Net cash provided by (used in) investing activities	(25,119,687)	(13,845,753)	(7,338,009)
Cash flows from financing activities:			
Proceeds from repurchase agreements	273,023,622	224,789,731	327,758,745
Principal payments on repurchase agreements	(253,387,283)	(223,342,427)	(329,520,501)
Proceeds from exercise of stock options	8,953	4,598	4,914
Issuance of Convertible Senior Notes	-	582,000	-
Proceeds from direct purchase and dividend reinvestment	455,547	278,784	141,775
Net proceeds from common stock follow-on offerings	5,351,846	1,047,354	-
Dividends paid	(2,041,489)	(1,599,339)	(1,269,420)
Net cash provided by (used in) financing activities	23,411,196	1,760,701	(2,884,487)
Net increase (decrease) in cash and cash equivalents	711,572	(1,221,942)	595,215
Cash and cash equivalents, beginning of year	282,626	1,504,568	909,353
Cash and cash equivalents, end of year	$994,198	$282,626	$1,504,568
Supplemental disclosure of cash flow information:			
Interest received	$4,309,690	$3,322,228	$3,146,933
Dividends received	$31,876	$30,042	$10,149
Fees received	$75,827	$54,467	$42,489
Interest paid (excluding interest paid on interest rate swaps)	$455,873	$411,608	$700,289
Net interest paid on interest rate swaps	$876,099	$725,418	$705,998
Taxes paid	$61,045	$36,742	$42,268
Noncash investing activities:			
Receivable for Investments sold	-	$151,460	$732,134
Payable for Investments purchased	$4,315,796	$4,575,026	$4,083,786
Net change in unrealized gains (losses) on available-for-sale securities and interest rate swaps, net of reclassification adjustment	$1,844,346	$(726,675)	$1,639,087
Noncash financing activities:			
Dividends declared, not yet paid	$552,806	$404,220	$414,851
Conversion of Series B Cumulative Convertible preferred stock	$7,759	$23,081	$32,928
Contingent beneficial conversion feature on Senior Convertible Notes	$60,087	-	-

See notes to consolidated financial statements.

ANNALY CAPITAL MANAGEMENT, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2011, 2010 AND 2009

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Annaly Capital Management, Inc. ("Annaly" or the "Company") was incorporated in Maryland on November 25, 1996. The Company commenced its operations of purchasing and managing an investment portfolio of mortgage-backed securities on February 18, 1997, upon receipt of the net proceeds from the private placement of equity capital, and completed its initial public offering on October 14, 1997. The Company is a real estate investment trust ("REIT") under the Internal Revenue Code of 1986, as amended. Fixed Income Discount Advisory Company ("FIDAC") is a registered investment advisor and is a wholly owned taxable REIT subsidiary of the Company. On June 27, 2006, the Company made a majority equity investment in an affiliated investment fund (the "Fund"), which is now wholly owned by the Company. During the third quarter of 2008, the Company formed RCap Securities, Inc. ("RCap"). RCap was granted membership in the Financial Industry Regulatory Authority ("FINRA") on January 26, 2009, and operates as a broker-dealer. RCap is a wholly owned taxable REIT subsidiary of the Company. On October 31, 2008, the Company acquired Merganser Capital Management, Inc. ("Merganser"). Merganser is a registered investment advisor and is a wholly owned taxable REIT subsidiary of the Company. In 2010, the Company established Shannon Funding LLC ("Shannon"), which provides warehouse financing to residential mortgage originators in the United States. In 2010, the Company also established Charlesfort Capital Management LLC ("Charlesfort"), which engages in corporate middle market lending transactions. In 2011, FIDAC established FIDAC Europe Limited ("FIDAC Europe"), which provides advice on commercial real estate transactions, including sale-leaseback and single tenant net leased properties across Europe. In 2011, the Company established FIDAC FSI LLC ("FIDAC FSI"), which invests in trading securities.

A summary of the Company's significant accounting policies follows:

The consolidated financial statements include the accounts of the Company, FIDAC, FIDAC Europe, FIDAC FSI, Merganser, RCap, Shannon, Charlesfort and the Fund. All intercompany balances and transactions have been eliminated.

Beginning with the Company's consolidated financial statements for the six month period ending June 30, 2011, the Company reclassified previously presented financial information so that amounts previously presented in the Consolidated Statements of Operations and Comprehensive Income (Loss) as interest expense on swaps are presented in Other income (loss) as Realized gains (losses) on interest rate swaps. Consolidated financial statements for periods prior to June 30, 2011 have been conformed to the restated presentation. Accordingly, interest expense for the years ended December 31, 2010 and 2009 decreased by $735.1 million and $719.8 million and Other income (loss) decreased by the same amounts, respectively to reflect the restated presentation. Additionally, in the Consolidated Statements of Operations and Comprehensive Income (Loss) and the Consolidated Statements of Cash Flows, prior year amounts have been reclassified for a consistent presentation with the year ended December 31, 2011.

Cash and Cash Equivalents - Cash and cash equivalents include cash on hand and cash held in money market funds on an overnight basis.

Reverse Repurchase Agreements - The Company enters into reverse repurchase agreements as part of the Company's matched book trading activity. Reverse repurchase agreements are recorded on trade date at the contract amount and are collateralized by mortgage-backed or other securities. Margin calls are made by the Company as necessary based on the daily valuation of the underlying collateral as compared to the contract price. The Company generates income

from the spread between what is earned on the reverse repurchase agreements and what is paid on the matched repurchase agreements. The Company's policy is to obtain possession of collateral with a market value in excess of the principal amount loaned under reverse repurchase agreements. To ensure that the market value of the underlying collateral remains sufficient, collateral is valued daily, and the Company will require counterparties to deposit additional collateral, when necessary. All reverse repurchase activities are transacted under master repurchase agreements that give the Company the right, in the event of default, to liquidate collateral held and to offset receivables and payables with the same counterparty.

Securities borrowed and loaned transactions – RCap records securities borrowed and loaned transactions at fair value. Securities borrowed transactions require RCap to provide the counterparty with collateral in the form of cash. RCap receives collateral in the form of cash for securities loaned transactions. For these transactions, the fees received or paid by RCap are recorded as interest income or expense, respectively. On a daily basis, market value changes of securities borrowed or loaned against the collateral value and RCap may require counterparties to deposit additional collateral or RCap may return collateral pledged, when appropriate.

U.S. Treasury Securities — RCap trades in U.S. Treasury Securities for its proprietary portfolio, which consists of long and short positions on U.S Treasury notes and bonds. U.S. Treasury securities are classified as trading investments and are recorded on trade date at cost. Changes in fair value are reflected in the Company's statement of operations. Generally the Company does not hold the U.S. Treasury bills, notes and bonds to maturity and realizes gains and losses from trading those positions. Interest income or expense on U.S Treasury notes and bonds is accrued based on the outstanding principal amount of those investments and their stated terms.

Investment Securities –Agency mortgage-backed securities, Agency debentures, and corporate debt are referred to herein as "Investment Securities." Although the Company generally intends to hold most of its Agency mortgage-backed securities and Agency debentures until maturity, it may, from time to time, sell any of its Agency mortgage-backed securities and Agency debentures as part of its overall management of its portfolio. Investment Securities classified as available-for-sale are reported at estimated fair value, based on fair values obtained and compared to independent sources, with unrealized gains and losses reported as a component of stockholders' equity. Investment Securities transactions are recorded on the trade date. Realized gains and losses on sales of Investment Securities are determined using the specific identification method.

On April 1, 2011, the Company elected the fair value option for interest-only mortgage-backed securities acquired on or after such date. These Agency interest-only mortgage-backed securities represent the Company's right to receive a specified proportion of the contractual interest flows of specific Agency mortgaged-backed securities. Agency Interest-only mortgage-backed securities acquired on or after April 1, 2011 are measured at fair value through earnings in the Company's Consolidated Statements of Operations and Comprehensive Income (Loss) . The interest-only securities are included in Agency mortgage-backed securities, at fair value on the accompanying Consolidated Statements of Financial Condition.

Agency Mortgage-Backed Securities and Agency Debentures – The Company invests primarily in mortgage pass-through certificates, collateralized mortgage obligations and other mortgage-backed securities representing interests in or obligations backed by pools of mortgage loans, and certificates guaranteed by Ginnie Mae, Freddie Mac or Fannie Mae (collectively, "Agency mortgage-backed securities"). The Company also invests in Agency debentures issued by Federal Home Loan Bank ("FHLB"), Freddie Mac, and Fannie Mae.

Interest income from coupon payments is accrued based on the outstanding principal amount of the Investment Securities and their contractual terms. Premiums and discounts associated with the purchase of the Investment Securities are amortized into interest income over the projected lives of the securities using the interest method. The Company's policy for estimating prepayment speeds for calculating the effective yield is to evaluate historical performance, consensus prepayment speeds, and current market conditions.

Equity Securities – The Company invests in equity securities that are classified as available-for-sale or trading. Equity securities classified as available-for-sale are reported at fair value, based on market quotes, with unrealized gains and losses reported as a component of stockholders' equity. Equity securities classified as trading are reported at fair value, based on market quotes, with unrealized gains and losses reported in the Statement of Operations and Comprehensive Income (Loss). Dividends are recorded in earnings on declaration date.

Other-Than-Temporary Impairment –Management evaluates available-for-sale securities for other-than-temporary impairment at least on a quarterly basis, and more frequently when economic or market concerns warrant such evaluation. The Company determines if it (1) has the intent to sell the securities, (2) is more likely than not that it will be required to sell the securities before recovery, or (3) does not expect to recover the entire amortized cost basis of the securities. Further, the security is analyzed for credit loss (the difference between the present value of cash flows expected to be collected and the amortized cost basis). The credit loss, if any, will then be recognized in the Consolidated Statements of Operations, while the balance of losses related to other factors will be recognized in other comprehensive income ("OCI"). There was no other-than-temporary impairment for the years ended December 31, 2011, 2010 and 2009.

Derivative Instruments – The Company accounts for interest rate swaps at fair value as either assets or liabilities on the Consolidated Statements of Financial Condition. The changes in the fair value of the interest rate swaps are recognized in earnings. The Company uses interest rate swaps to manage its exposure to changing interest rates on its repurchase agreements. Net payments on interest rate swaps are included in the Consolidated Statements of Cash Flows as a component of operating activities.

The Company elected to net by counterparty the fair value of interest rate swap contracts. These contracts contain legally enforceable provisions that allow for netting or setting off of all individual swap receivables and payables with each counterparty and, therefore, the fair value of those swap contracts are netted by counterparty. The credit support annex provisions of the Company's interest rate swap contracts allow the parties to mitigate their credit risk by requiring the party which is out of the money to post collateral. As the Company elects to net by counterparty the fair value of interest rate swap contracts, it also nets by counterparty any collateral exchanged as part of the interest rate swap contracts. Substantially all collateral is non-cash collateral under these contracts.

In addition, the Company's agreements with certain of its counterparties with whom it has both interest rate swap contracts and master repurchase agreements contain legally enforceable provisions that allow for netting or setting off of on an aggregate basis all receivables, payables and collateral postings required under both the interest rate swap contract and the master repurchase agreement with respect to each such counterparty.

RCap enters primarily into U.S. Treasury, Eurodollar, and federal funds futures and options contracts for speculative or hedging purposes. RCap maintains a margin account which is settled daily with futures and options commission merchants. Changes in the unrealized gains or losses on the futures and options contracts are reflected in the Company's Consolidated Statements of Operations. Unrealized gains (losses) are removed from net income (loss) as an adjustment to cash flows from operating activities in the Consolidated Statements of Cash Flows.

Credit Risk – The Company has limited its exposure to credit losses on its portfolio of Agency mortgage-backed securities by only purchasing securities issued by Freddie Mac, Fannie Mae or Ginnie Mae and Agency debentures issued by the FHLB, Freddie Mac and Fannie Mae. The payment of principal and interest on the Freddie Mac and Fannie Mae Agency mortgage-backed securities are guaranteed by those respective agencies, and the payment of principal and interest on the Ginnie Mae Agency mortgage-backed securities are backed by the full faith and credit of the U.S. government. Principal and interest on Agency debentures are guaranteed by the agency issuing the debenture. Substantially all of the Company's Investment Securities have an actual or implied "AAA" rating. The Company faces credit risk on the portions of its portfolio which are not Agency mortgage-backed securities and Agency debentures.

Market Risk - Weakness in the mortgage market may adversely affect the performance and market value of the Company's investments. This could negatively impact the Company's net book value. Furthermore, if many of the Company's lenders are unwilling or unable to provide additional financing, the Company could be forced to sell its Investment Securities at an inopportune time when prices are depressed. The Company does not anticipate having difficulty converting its assets to cash or extending financing terms due to the fact that its Agency mortgage-backed securities and Agency debentures have an actual or implied "AAA" rating and principal payment is guaranteed by Freddie Mac, Fannie Mae, or Ginnie Mae.

Repurchase Agreements - The Company finances the acquisition of its Agency mortgage-backed securities and Agency debentures through the use of repurchase agreements. Repurchase agreements are treated as collateralized financing transactions and are presented at their contractual principal amounts as specified in the respective agreements. Reverse repurchase agreements and repurchase agreements with the same counterparty and the same maturity are presented net in the Consolidated Statements of Financial Condition when the terms of the agreements permit netting. The Company reports cash flows on repurchase agreements as financing activities in the Consolidated

Statements of Cash Flows. The Company reports cash flows on repurchase agreements entered into by RCap and Shannon as operating activities in the Consolidated Statements of Cash Flows.

Convertible Senior Notes – The Company records the Convertible Senior Notes at their contractual amounts, adjusted by the effect of the beneficial conversion feature. The Convertible Senior Notes have a conversion price adjustment feature that is evaluated at the time of the conversion price adjustment. A contingent beneficial conversion feature was recognized in the year ended December 31, 2011 as a result of adjustments to the conversion price for dividends declared. The Company determined the intrinsic value of the contingent beneficial conversion feature. This intrinsic value is included in "Additional paid in capital" on the Company's Consolidated Statements of Financial Condition and, therefore, reduces the liability associated with the Convertible Senior Notes.

Cumulative Convertible Preferred Stock - The Series B Cumulative Convertible Preferred Stock (the "Series B Preferred Stock") contains fundamental change provisions that allow the holder to redeem the Series B Preferred Stock for cash if certain events occur. As redemption under these provisions is not solely within the Company's control, the Company has classified the Series B Preferred Stock as temporary equity in the accompanying Consolidated Statements of Financial Condition.

Income Taxes - The Company has elected to be taxed as a REIT and intends to comply with the provisions of the Internal Revenue Code of 1986, as amended (the "Code"), with respect thereto. Accordingly, the Company will not be subjected to federal income tax to the extent of its distributions to shareholders and as long as certain asset, income and stock ownership tests are met. The Company and its direct and indirect subsidiaries, FIDAC, FIDAC Europe, Merganser and RCap, have made separate joint elections to treat these subsidiaries as taxable REIT subsidiaries. As such, each of the taxable REIT subsidiaries are taxable as a domestic C corporation and subject to federal, state, and local income taxes based upon its taxable income.

The provisions of Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 740, Income Taxes, clarify the accounting for uncertainty in income taxes recognized in financial statements and prescribe a recognition threshold and measurement attribute for tax positions taken or expected to be taken on a tax return. ASC 740 also requires that interest and penalties related to unrecognized tax benefits be recognized in financial statements. The Company does not have any unrecognized tax benefits that would affect its financial position. Thus, no accruals for penalties and interest were necessary as of December 31, 2011.

Goodwill and Intangible Assets - The Company's acquisitions of FIDAC, Merganser, and FIDAC Europe were accounted for using the purchase method. Under the purchase method, net assets and results of operations of acquired companies are included in the consolidated financial statements from the date of acquisition. The costs of FIDAC and Merganser were allocated to the assets acquired, including identifiable intangible assets, and the liabilities assumed based on their estimated fair values at the date of acquisition. The excess of purchase price over the fair value of the net assets acquired was recognized as goodwill. In addition, FIDAC Europe acquired a customer relationship after its formation. Goodwill and intangible assets are periodically (but not less frequently than annually) reviewed for potential impairment. Intangible assets with an estimated useful life are expected to amortize over a 7.7 year weighted average time period. During the years ended December 31, 2011, 2010 and 2009, there were no impairment losses.

Stock Based Compensation - The Company is required to measure and recognize in the consolidated financial statements the compensation cost relating to share-based payment transactions. The Company recognizes compensation expense on a straight-line basis over the requisite service period for the entire award.

Use of Estimates - The preparation of the consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. All assets classified as trading or available-for-sale and interest rate swaps are reported at their estimated fair value, based on market prices. The Company's policy is to obtain fair values from one or more independent sources to compare to internal prices for reasonableness. Actual results could

differ from those estimates.

A Summary of Recent Accounting Pronouncements Follows:

Presentation

Balance Sheet (ASC 210)

On December 23, 2011, FASB released ASU 2011-11 regarding disclosures concerning the offsetting of assets and liabilities. Under this update, the Company will be required to disclose both gross information and net information about both instruments and transactions eligible for offset in the statement of financial position and transactions subject to an agreement similar to a master netting arrangement. The scope would include derivatives, sale and repurchase agreements and reverse sale and repurchase agreements and securities borrowing and securities lending arrangements. This disclosure is intended to enable financial statement users to understand the effect of such arrangements on the Company's financial position. The objective of this update is to support further convergence of US GAAP and IFRS requirements. This update is effective for annual reporting periods beginning on or after January 1, 2013.

Comprehensive Income (ASC 220)

In June 2011, FASB released Accounting Standards Update ("ASU") 2011-05, which attempts to improve the comparability, consistency, and transparency of financial reporting and increase the prominence of items reported in other comprehensive income ("OCI"). The amendment requires that all non-owner changes in stockholders' equity be presented either in a single continuous statement of net income and comprehensive income or two separate consecutive statements. Either presentation requires the presentation on the face of the financial statements any reclassification adjustments for items that are reclassified from OCI to net income in the statements. There is no change in what must be reported in OCI or when an item of OCI must be reclassified to net income. This update is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. This update will result in additional disclosure, but has no material effect on the Company's consolidated financial statements. On December 23, 2011, the FASB issued ASU 2011-12, which defers those changes in ASU 2011-05 that relate to the presentation of reclassification adjustments out of accumulated OCI. This was done to allow the Board time to re-deliberate the presentation on the face of the financial statements the effects of reclassifications out of accumulated OCI on the components of net income and OCI. No other requirements under ASU 2011-05 are affected by this update.

Assets

Intangibles – Goodwill and Other (ASC 350)

In September 2011, FASB released ASU 2011-08, which allows an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. The objective of the update is to simplify how entities test goodwill for impairment. Under this update, an entity is not required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount. This update if effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The Company is not eligible to elect early adoption. This update has no material effect on the Company's consolidated financial statements.

Broad Transactions

Fair Value Measurements and Disclosures (ASC 820)

In May 2011, FASB released ASU 2011-04 further converging US GAAP and IFRS by providing common fair value measurement and disclosure requirements. The amendments in this update change the wording used to describe the requirements in US GAAP for measuring fair value and for disclosing information about fair value measurements. These include those that clarify the FASB's intent about the application of existing fair value measurement and disclosure requirements and those that change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. This guidance is effective for interim and annual reporting periods beginning after December 15, 2011. This update may result in additional disclosure and the Company is evaluating the effect on the Company's consolidated financial statements.

Transfers and Servicing (ASC 860)

In April 2011, FASB issued ASU 2011-03 regarding repurchase agreements. In a typical repurchase agreement transaction, an entity transfers financial assets to the counterparty in exchange for cash with an agreement for the counterparty to return the same or equivalent financial assets for a fixed price in the future. Previous to this update, one of the factors in determining whether sale treatment could be used was whether the transferor maintained effective control of the transferred assets and in order to do so, the transferor must have the ability to repurchase such assets. Based on this update, the FASB concluded that the assessment of effective control should focus on a transferor's contractual rights and obligations with respect to transferred financial assets, rather than whether the transferor has the practical ability to perform in accordance with those rights or obligations. Therefore, this update removes the transferor's ability criterion from consideration of effective control. This update is effective for the first interim or annual period beginning on or after December 15, 2011. As the Company records repurchase agreements as secured borrowings and not sales, this update will have no effect on the Company's consolidated financial statements.

Financial Services – Investment Companies (ASC 946)

In October 2011, FASB issued a proposed ASU 2011-200 which would amend the criteria in Topic 946 for determining whether an entity qualifies as an investment company. The proposed ASU would affect the measurement, presentation and disclosure requirements for investment companies. This proposed update amends the investment company definition in ASC 946 and removes the current exemption for Real Estate Investment Trusts from this topic. The proposed update if promulgated in its current form may result in material modification to the presentation of the Company's consolidated financial statements and the Company is currently evaluating the full effect of the proposed update if promulgated in its current form.

2. AGENCY MORTGAGE-BACKED SECURITIES

The following tables present the Company's available-for-sale Agency mortgage-backed securities portfolio as of December 31, 2011 and 2010 which were carried at their fair value:

December 31, 2011	Freddie Mac	Fannie Mae	Ginnie Mae	Total Mortgage-Backed Securities
	(dollars in thousands)			
Agency mortgage-backed Securities, par value	$ 34,395,542	$ 63,066,372	$ 500,968	$ 97,962,882
Unamortized discount	(9,874)	(13,632)	(399)	(23,905)
Unamortized premium	1,139,881	2,205,138	15,949	3,360,968
Amortized cost	35,525,549	65,257,878	516,518	101,299,945
Gross unrealized gains	973,476	2,081,282	31,474	3,086,232
Gross unrealized losses	(15,243)	(118,871)	(1,008)	(135,122)
Estimated fair value	$ 36,483,782	$ 67,220,289	$ 546,984	$ 104,251,055

	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Estimated Fair Value
	(dollars in thousands)			
Adjustable rate	$ 8,698,746	$ 345,642	$ (3,188)	$ 9,041,200
Fixed rate	92,601,199	2,740,590	(131,934)	95,209,855
Total	$ 101,299,945	$ 3,086,232	$ (135,122)	$ 104,251,055

December 31, 2010	Freddie Mac	Fannie Mae	Ginnie Mae	Total Mortgage-Backed Securities
	(dollars in thousands)			
Agency mortgage-backed Securities, par value	$ 19,846,543	$ 54,341,140	$ 824,029	$ 75,011,712
Unamortized discount	(14,651)	(18,329)	(403)	(33,383)
Unamortized premium	517,507	1,795,116	26,200	2,338,823
Amortized cost	20,349,399	56,117,927	849,826	77,317,152
Gross unrealized gains	463,471	1,211,324	29,408	1,704,203
Gross unrealized losses	(140,027)	(438,918)	(2,080)	(581,025)
Estimated fair value	$ 20,672,843	$ 56,890,333	$ 877,154	$ 78,440,330

	Amortized Cost	Gross Unrealized	Gross Unrealized	Estimated Fair Value

		Gain	Loss	
		(dollars in thousands)		
Adjustable rate	$ 10,954,627	$ 257,822	$ (75,440)	$ 11,137,009
Fixed rate	66,362,525	1,446,381	(505,585)	67,303,321
Total	$ 77,317,152	$ 1,704,203	$ (581,025)	$ 78,440,330

Actual maturities of Agency Mortgage-Backed Securities are generally shorter than stated contractual maturities because actual maturities of Agency Mortgage-Backed Securities are affected by the contractual lives of the underlying mortgages, periodic payments of principal, and prepayments of principal. The following table summarizes the Company's Agency Mortgage-Backed Securities on December 31, 2011 and 2010, according to their estimated weighted-average life classifications:

	December 31, 2011		December 31, 2010	
Weighted-Average Life	Fair Value	Amortized Cost	Fair Value	Amortized Cost
	(dollars in thousands)			
Less than one year	$1,715,530	$1,697,101	$915,398	$901,824
Greater than one year through five years	97,344,791	94,534,782	59,732,123	58,321,570
Greater than five years through ten years	4,447,540	4,348,841	17,044,652	17,339,127
Greater than 10 years	743,194	719,221	748,157	754,631
Total	$104,251,055	$101,299,945	$78,440,330	$77,317,152

The weighted-average lives of the Agency mortgage-backed securities at December 31, 2011 and 2010 in the table above are based upon data provided through subscription-based financial information services, assuming constant principal prepayment rates to the reset date of each security. The prepayment model considers current yield, forward yield, steepness of the yield curve, current mortgage rates, mortgage rate of the outstanding loans, loan age, margin and volatility. The actual weighted average lives of the Agency mortgage-backed securities could be longer or shorter than estimated.

The following table presents the gross unrealized losses, and estimated fair value of the Company's Agency mortgage-backed securities by length of time that such securities have been in a continuous unrealized loss position at December 31, 2011 and December 31, 2010.

	Unrealized Loss Position For: (dollars in thousands)					
	Less than 12 Months		12 Months or More		Total	
	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses
December 31, 2011	$1,087,552	$(118,593)	$883,143	$(16,529)	$1,970,695	$(135,122)
December 31, 2010	$28,608,996	$(577,096)	$166,481	$(3,929)	$28,775,477	$(581,025)

The decline in value of these securities is solely due to market conditions and not the quality of the assets. Substantially all of the Agency mortgage-backed securities are "AAA" rated or carry an implied "AAA" rating. The investments are not considered other-than-temporarily impaired because the Company currently has the ability and intent to hold the investments to maturity or for a period of time sufficient for a forecasted market price recovery up to or beyond the cost of the investments or we are required to sell for regulatory or other reasons. Also, the Company is guaranteed payment of the principal amount of the securities by the government agency which created them.

During the year ended December 31, 2011, the Company sold $18.7 billion of Agency mortgage-backed securities, resulting in a realized gain of $199.2 million. During the year ended December 31, 2010, the Company sold $7.8

billion of Agency mortgage-backed securities, resulting in a realized gain of $171.6 million. Average cost is used as the basis on which the cost of the securities are sold.

Agency interest-only mortgage-backed securities represent the right to receive a specified portion of the contractual interest flows of the underlying unamortized principal balance of specific Agency mortgage-backed securities. As of December 31, 2011, Agency interest-only mortgage-backed securities had unrealized losses of $123.1 million (consisting of unrealized losses of $106.7 million included in net income and unrealized loss of $16.4 million included in other comprehensive income) and an amortized cost of $405.1 million.

3. AGENCY DEBENTURES

At December 31, 2011, the Company owned Agency debentures with a carrying value of $889.6 million, including an unrealized gain of $3.7 million. At December 31, 2010, the Company owned Agency debentures with a carrying value of $1.1 billion including an unrealized gain of $9.7 million.

During the year ended December 31, 2011, the Company sold or had called $1.4 billion of Agency debentures, resulting in realized gains of $7.7 million. During the year ended December 31, 2010, the Company sold or had called $2.8 billion of Agency debentures, resulting in realized gains of $10.2 million.

4. INVESTMENT IN AFFILIATES, AVAILABLE-FOR-SALE EQUITY SECURITIES

Substantially all of the Company's available-for-sale equity securities are shares of Chimera Investment Corporation ("Chimera") and CreXus Investment Corp. ("CreXus") and are reported at fair value. The Company owned approximately 45.0 million shares of Chimera at a fair value of approximately $112.9 million at December 31, 2011 and approximately 45.0 million shares of Chimera at a fair value of approximately $184.9 million at December 31, 2010. At December 31, 2011, the investment in Chimera had an unrealized loss of $25.9 million. The Company owned approximately 9.5 million shares of CreXus at a fair value of approximately $98.9 million at December 31, 2011 and approximately 4.5 million shares of CreXus at a fair value of approximately $59.3 million at December 31, 2010. At December 31, 2011, the investment in CreXus had an unrealized loss of $26.5 million.

The Company determined other-than-temporary impairment was not necessary for the years ended December 31, 2011, 2010 and 2009 as the Company has the intent and ability to retain its investments for a period of time sufficient to allow for any anticipated recovery in market value.

5. REVERSE REPURCHASE AGREEMENT

At December 31, 2011, RCap had outstanding reverse repurchase agreements with non-affiliates of $849.4 million. At December 31, 2010, RCap had outstanding reverse repurchase agreements with non-affiliates of $1.0 billion. At December 31, 2011, Shannon had outstanding reverse repurchase agreements with non-affiliates of $11.5 million.

6. FAIR VALUE MEASUREMENTS

The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

Level 1– inputs to the valuation methodology are quoted prices (unadjusted) for identical assets and liabilities in active markets.

Level 2 – inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

Level 3 – inputs to the valuation methodology are unobservable and significant to overall fair value.

Available for sale equity securities are valued based on quoted prices (unadjusted) in an active market. Agency mortgage-backed securities and interest rate swaps are valued using quoted prices or internal prices for similar assets and dealer quotes. The Company will incorporate common market pricing methods, including a spread measurement to the Treasury curve as well as underlying characteristics of the particular security including coupon, periodic and life

caps, rate reset period and expected life of the security. Management ensures that current market conditions are represented. Management compares internal prices are compared to outside sources and dealer quotes.

The Company's Investment Securities characteristics are as follows:

	Weighted Average Coupon on Fixed Rate Investments	Weighted Average Coupon on Adjustable Rate Investments	Weighted Average Yield on Fixed Rate Investments	Weighted Average Yield on Adjustable Rate Investments	Weighted Average Lifetime Cap on Adjustable Investments	Weighted Average Term to Next Adjustment on Adjustable Rate Investments
At December 31, 2011	4.71 %	3.88 %	3.07 %	2.79 %	9.64 %	41 months
At December 31, 2010	4.92 %	4.28 %	4.00 %	3.04 %	10.16 %	39 months

During the fourth quarter, we changed our discount rate assumption used to determine the fair value of interest rate swaps from LIBOR to the overnight index swap ("OIS") rate in response to changes in market valuation practices for interest rate swaps that are collateralized. The impact on the fair value of our interest rate swaps was not significant.

The classification of assets and liabilities by level remains unchanged at December 31, 2011, when compared to the year ended December 31, 2010, with the exception of equity securities which were acquired during the year ended December 31, 2011. The Company's financial assets and liabilities carried at fair value on a recurring basis are valued as follows:

	Level 1	Level 2	Level 3
At December 31, 2011		(dollars in thousands)	
Assets:			
Agency mortgage-backed securities	$-	$104,251,055	$-
Agency debentures	-	889,580	-
Investment in affiliates	211,970	-	-
U.S. Treasury Securities	928,547	-	-
Equity securities	3,891	-	-
Securities borrowed	-	928,732	-
Other derivative contracts	113	-	-
Liabilities:			
Interest rate swaps	-	2,552,687	-
U.S. Treasury securities sold, not yet purchased	826,912	-	-
Securities loaned	-	804,901	-

	Level 1	Level 2	Level 3
At December 31, 2010		(dollars in thousands)	
Assets:			
Agency mortgage-backed securities	$-	$78,440,330	$-
Agency debentures	-	1,108,261	-
Investments in affiliates	184,879	-	-
U.S. Treasury securities	1,100,447	-	-
Securities borrowed	-	216,676	-
Interest rate swaps	-	2,561	-
Other derivative contracts	2,607	-	-
Liabilities:			
Interest rate swaps	-	754,439	-

U.S. Treasury securities sold, not yet purchased	909,462	-	-
Securities loaned	-	217,841	-
Other derivative contracts	-	2,446	-

The carrying amount of cash and cash equivalents, reverse repurchase agreements, receivable for Agency mortgage-backed securities sold, accrued interest and dividends receivable, receivable for advisory and service fees, repurchase agreements with maturities shorter than one year, payable for investments purchased, dividends payable, accounts payable and other liabilities and accrued interest payable, generally approximates fair value at December 31, 2011 due to the short term nature of these items.

7. REPURCHASE AGREEMENTS

The Company had outstanding $84.1 billion and $65.5 billion of repurchase agreements with weighted average borrowing rates of 1.59% and 1.84%, after giving effect to the Company's interest rate swaps, and weighted average remaining maturities of 103 days and 127 days as of December 31, 2011 and December 31, 2010, respectively. Investment Securities and U.S. Treasury Securities pledged as collateral under these repurchase agreements and interest rate swaps had an estimated fair value of $91.3 billion at December 31, 2011 and $69.5 billion at December 31, 2010.

At December 31, 2011 and 2010, the repurchase agreements had the following remaining maturities:

	December 31, 2011	December 31, 2010
	(dollars in thousands)	
1 day	$ 508,647	-
Within 30 days	33,780,070	$ 32,669,341
30 to 59 days	28,346,380	13,767,522
60 to 89 days	3,699,425	4,776,597
90 to 119 days	6,781,137	6,068,376
Over 120 days	10,982,226	8,251,701
Total	$ 84,097,885	$ 65,533,537

The Company did not have an amount at risk greater than 10% of the equity of the Company with any counterparty as of December 31, 2011 or December 31, 2010.

Additionally, as of December 31, 2011 and December 31, 2010, the Company has entered into repurchase agreements with a term of over one year. The amount of the repurchase agreements is $4.9 billion and $6.4 billion and they have an estimated fair value of ($5.2 billion) and ($6.7 billion) as of December 31, 2011 and December 31, 2010, respectively.

8. DERIVATIVE INSTRUMENTS

In connection with the Company's interest rate risk management strategy, the Company economically hedges a portion of its interest rate risk by entering into derivative financial instrument contracts. As of December 31, 2011, such instruments are comprised of interest rate swaps, which in effect modify the cash flows on repurchase agreements. The use of interest rate swaps creates exposure to credit risk relating to potential losses that could be recognized if the counterparties to these instruments fail to perform their obligations under the contracts. The purpose of the swaps is to mitigate the risk of rising interest rates that affect the Company's cost of funds. In the event of a default by the counterparty, the Company could have difficulty obtaining its Investment Securities pledged as collateral for swaps. The Company does not anticipate any defaults by its counterparties.

The location and fair value of derivative instruments reported in the Consolidated Statement of Financial Position as of December 31, 2011 and 2010 are as follows:

	Location on Statement of Financial Condition	Notional Amount	Net Estimated Fair Value/Carrying Value
	(dollars in thousands)		

Interest rate swaps					
December 31, 2011	Liabilities	$	40,109,880	$	(2,552,687)
December 31, 2011	Assets		-		-
December 31, 2010	Liabilities	$	26,882,460	$	(754,439)
December 31, 2010	Assets	$	200,000	$	2,561

The effect of derivatives on the Consolidated Statements of Operations and Comprehensive Income (Loss) is as follows:

	Location on Statement of Operations and Comprehensive Income	
	Realized Gains (Losses) Recognized on Interest Rate Swaps*	Unrealized Gains (Losses) on Interest Rate Swaps
	(dollars in thousands)	
For the Year Ended December 31, 2011	$ (882,395)	$ (1,815,107)
For the Year Ended December 31, 2010	$ (735,107)	$ (318,832)
For the Year Ended December 31, 2009	$ (719,803)	$ 349,521

* Net interest payments on interest rate swaps is presented in the Company's Consolidated Statements of Operations and Comprehensive Income (Loss) as realized gains (losses) on interest rate swaps.

The weighted average pay rate at December 31, 2011 was 2.55% and the weighted average receive rate was 0.33%. The weighted average pay rate at December 31, 2010 was 3.21% and the weighted average receive rate was 0.28%. Without netting the market value of the swaps by dealer at December 31, 2011, the gross unrealized loss on interest rate swaps was $2.6 billion, with a notional amount of $40.1 billion. Without netting the market value of the swaps by dealer at December 31, 2010, the gross unrealized loss on interest rate swaps was $820.0 million, with a notional amount of $23.2 billion and the gross unrealized gain on interest rate swaps was $68.2 million, with a notional amount of $3.9 billion.

In connection with RCap's proprietary trading activities, it has entered into U.S. Treasury, Eurodollar, and federal funds futures and options contracts for speculative or hedging purposes. RCap invests in futures and options contracts for economic hedging purposes to reduce exposure to changes in yields of its U.S Treasury securities and for speculative purposes to achieve capital appreciation. The use of futures and options contracts creates exposure to credit risk relating to potential losses that could be recognized if the counterparties to these instruments fail to perform their obligations under the contracts. RCap executes these trades through an independent futures and options broker dealer.

9. CONVERTIBLE SENIOR NOTES

In 2010, Company issued $600.0 million in aggregate principal amount of its 4% convertible senior notes due 2015 ("Convertible Senior Notes") for net proceeds following expenses of approximately $582.0 million. Interest on the Convertible Senior Notes is paid semi-annually at a rate of 4% per year and the Convertible Senior Notes will mature on February 15, 2015 unless earlier repurchased or converted. The Convertible Senior Notes are convertible into shares of Common Stock at an initial conversion rate and conversion rate at December 31, 2011 of 46.6070 and 62.2331 shares of Common Stock, respectively, per $1,000 principal amount of Convertible Senior Notes, which is equivalent to an initial conversion price and conversion price at December 31, 2011 of approximately $21.4560 and $16.0686 per share of Common Stock, respectively, subject to adjustment in certain circumstances. There is no limit on the total number of shares of Common Stock that we would be required to issue, upon a conversion. During the year ended December 31, 2011, it was determined that there was a contingent beneficial conversion feature. During the year ended December 31, 2010, there was not a contingent beneficial conversion feature. The intrinsic value of the contingent beneficial conversion feature was $60.1 million at December 31, 2011. This intrinsic value is included in "Additional paid in capital" on the Company's Consolidated Statements of Financial Condition and, therefore, reduces the liability associated with the Convertible Senior Notes. The $60.1 million discount to the principal amount of the

Convertible Senior Notes is recognized in interest expense over the remaining life of the notes using the effective yield method. The market value of the Convertible Senior Notes at December 31, 2011 and December 31, 2010 was $685.5 million and $699.2 million, respectively, based on closing price.

10. PREFERRED STOCK AND COMMON STOCK

(A) Common Stock

On June 23, 2011, the Company amended its charter to increase the number of authorized shares of capital stock, par value $0.01 per share, from 1,000,000,000 shares to 2,000,000,000 shares, consisting of 1,987,987,500 shares classified as Common Stock, 7,412,500 shares classified as 7.875% Series A Cumulative Redeemable Preferred Stock, and 4,600,000 shares classified as 6.00% Series B Cumulative Convertible Preferred Stock.

On July 11, 2011 the Company entered into an agreement pursuant to which it sold 138,000,000 shares of its common stock for net proceeds following expenses of approximately $2.4 billion. This transaction settled on July 15, 2011.

On February 15, 2011 the Company entered into an agreement pursuant to which it sold 86,250,000 shares of its common stock for net proceeds following expenses of approximately $1.5 billion. This transaction settled on February 18, 2011.

On January 4, 2011 the Company entered into an agreement pursuant to which it sold 86,250,000 shares of its common stock for net proceeds following expenses of approximately $1.5 billion. This transaction settled on January 7, 2011.

During the year ended December 31, 2011, 679,000 options were exercised under the Long-Term Stock Incentive Plan, or Incentive Plan, for an aggregate exercise price of $9.0 million.

During the year ended December 31, 2011, 320,000 shares of Series B Preferred Stock were converted into 906,000 shares of common stock.

During the year ended December 31, 2011, the Company raised $455.5 million by issuing 26.2 million shares, through the Direct Purchase and Dividend Reinvestment Program.

On July 13, 2010 the Company entered into an agreement pursuant to which it sold 60,000,000 shares of its common stock for net proceeds following expenses of approximately $1.0 billion. This transaction settled on July 19, 2010.

During the year ended December 31, 2010, 364,000 options were exercised under the Incentive Plan for an aggregate exercise price of $4.6 million.

During the year ended December 31, 2010, 953,000 shares of Series B Preferred Stock were converted into 2.4 million shares of common stock, respectively.

During the year ended December 31, 2010, the Company raised $278.8 million by issuing 15.7 million shares through the Direct Purchase and Dividend Reinvestment Program.

(B) Preferred Stock

At December 31, 2011 and 2010, the Company had issued and outstanding 7,412,500 shares of Series A Cumulative Redeemable Preferred Stock (“Series A Preferred Stock”), with a par value $0.01 per share and a liquidation preference of $25.00 per share plus accrued and unpaid dividends (whether or not declared). The Series A Preferred Stock must be paid a dividend at a rate of 7.875% per year on the $25.00 liquidation preference before the common stock is entitled to receive any dividends. The Series A Preferred Stock is redeemable at $25.00 per share plus accrued and unpaid dividends (whether or not declared) exclusively at the Company's option commencing on April 5, 2009 (subject to the Company's right under limited circumstances to redeem the Series A Preferred Stock earlier in order to preserve its qualification as a REIT). The Series A Preferred Stock is senior to the Company's common stock and is on parity with the Series B Preferred Stock with respect to dividends and distributions, including distributions upon liquidation, dissolution or winding up. The Series A Preferred Stock generally does not have any voting rights, except if the Company fails to pay dividends on the Series A Preferred Stock for six or more quarterly periods (whether or not consecutive). Under such circumstances, the Series A Preferred Stock, together with the Series B Preferred Stock, will be entitled to vote to elect two additional directors to the Board, until all unpaid dividends have been paid or declared and set apart for payment. In addition, certain material and adverse changes to the terms of the Series A Preferred Stock cannot be made without the affirmative vote of holders of at least two-thirds of the outstanding shares

of Series A Preferred Stock and Series B Preferred Stock. Through December 31, 2011, the Company had declared and paid all required quarterly dividends on the Series A Preferred Stock.

At December 31, 2011 and 2010, the Company had issued and outstanding 1,331,849 and 1,652,047, respectively, shares of Series B Preferred Stock with a par value $0.01 per share and a liquidation preference of $25.00 per share plus accrued and unpaid dividends (whether or not declared). The Series B Preferred Stock must be paid a dividend at a rate of 6% per year on the $25.00 liquidation preference before the common stock is entitled to receive any dividends.

The Series B Preferred Stock is not redeemable. The Series B Preferred Stock is convertible into shares of common stock at a conversion rate that adjusts from time to time upon the occurrence of certain events, including if the Company distributes to its common shareholders in any calendar quarter cash dividends in excess of $0.11 per share. Initially, the conversion rate was 1.7730 shares of common shares per $25 liquidation preference. At December 31, 2011, the conversion ratio was 2.9784 shares of common stock per $25 liquidation preference. Commencing April 5, 2011, the Company has the right in certain circumstances to convert each Series B Preferred Stock into a number of common shares based upon the then prevailing conversion rate. The Series B Preferred Stock is also convertible into common shares at the option of the Series B preferred shareholder at anytime at the then prevailing conversion rate. The Series B Preferred Stock is senior to the Company's common stock and is on parity with the Series A Preferred Stock with respect to dividends and distributions, including distributions upon liquidation, dissolution or winding up. The Series B Preferred Stock generally does not have any voting rights, except if the Company fails to pay dividends on the Series B Preferred Stock for six or more quarterly periods (whether or not consecutive). Under such circumstances, the Series B Preferred Stock, together with the Series A Preferred Stock, will be entitled to vote to elect two additional directors to the Board, until all unpaid dividends have been paid or declared and set apart for payment. In addition, certain material and adverse changes to the terms of the Series B Preferred Stock cannot be made without the affirmative vote of holders of at least two-thirds of the outstanding shares of Series B Preferred Stock and Series A Preferred Stock. There is no limit on the total number of shares of Common Stock that we would be required to issue, upon a conversion. Through December 31, 2011, the Company had declared and paid all required quarterly dividends on the Series B Preferred Stock. During the year ended December 31, 2011, 320,000 shares of Series B Preferred Stock were converted into 906,000 shares of common stock. During the year ended December 31, 2010, 953,000 shares of Series B Preferred Stock were converted into 2.4 million shares of common stock.

(C) Distributions to Shareholders

During the year ended December 31, 2011, the Company declared dividends to common shareholders totaling $2.2 billion or $2.44 per share, of which $552.8 million were paid to shareholders on January 27, 2012. Dividend distributions for the year ended December 31, 2011, were characterized, for Federal income tax purposes, as 95.1% ordinary income, 4.9% long-term capital. During the year ended December 31, 2011, the Company declared dividends to Series A Preferred shareholders totaling approximately $14.6 million or $1.97 per share, and Series B shareholders totaling approximately $2.3 million or $1.50 per share, which were paid to shareholders on January 3, 2012.

During the year ended December 31, 2010, the Company declared dividends to common shareholders totaling $1.6 billion or $2.65 per share, of which $404.2 million were paid to shareholders on January 27, 2011. Dividend distributions for the year ended December 31, 2010, were characterized, for Federal income tax purposes as 94.3% ordinary income, 5.7% long- term capital. During the year ended December 31, 2010, the Company declared dividends to Series A Preferred shareholders totaling approximately $14.6 million or $1.97 per share, and Series B shareholders totaling approximately $3.4 million or $1.50 per share, both of which were paid to shareholders on December 31, 2010.

11. NET INCOME PER COMMON SHARE

The following table presents a reconciliation of net income and shares used in calculating basic and diluted earnings per share for the years ended December 31, 2011, 2010, and 2009.

	For the years ended (amounts in thousands)

	December 31, 2011	December 31, 2010	December 31, 2009
Net income	$ 344,461	$ 1,267,280	$ 1,961,471
Less: Preferred stock dividends	16,854	18,033	18,501
Net income available to common shareholders, prior to adjustment for Series B dividends, if necessary	327,607	1,249,247	1,942,970
Add: Preferred Series B dividends, if dilutive	-	3,440	3,908
Add: Interest on Convertible Senior Note, if dilutive	-	21,333	-
Net income available to common shareholders, as adjusted	$ 327,607	$ 1,274,020	$ 1,946,878
Weighted average shares of common stock outstanding-basic	874,212	588,193	546,973
Add: Effect of dilutive stock options, Series B Cumulative Convertible Preferred Stock and Convertible Senior Notes, if dilutive	307	37,114	6,158
Weighted average shares of common stock outstanding-diluted	874,519	625,307	553,131

Options to purchase 572,000 shares of common stock were outstanding and considered anti-dilutive as their exercise price and option expense exceeded the average stock price for the year ended December 31, 2011. Options to purchase 565,000 shares of common stock, were outstanding and considered anti-dilutive as their exercise price and option expense exceeded the average stock price for the year ended December 31, 2010. Options to purchase 2.8 million shares of common stock, were outstanding and considered anti-dilutive as their exercise price and option expense exceeded the average stock price for the year ended December 31, 2009.

12. LONG-TERM STOCK INCENTIVE PLAN

The Company has adopted the 2010 Equity Incentive Plan, which authorizes the Compensation Committee of the board of directors to grant options, stock appreciation rights, dividend equivalent rights, or other share-based award, including restricted shares up to an aggregate of 25,000,000 shares, subject to adjustments as provided in the 2010 Equity Incentive Plan. On June 27, 2011 the Company granted to each non-management director of the Company options to purchase 1,250 shares of the Company's common stock under the 2010 Equity Incentive Plan. The stock options were issued at the current market price on the date of grant and immediately vested with a contractual term of 5 years. The grant date fair value is calculated using the Black-Scholes option valuation model. The Company had adopted a long term stock incentive plan for executive officers, key employees and non-employee directors (the Prior Plan). The Prior Plan authorized the Compensation Committee of the board of directors to grant awards, including non-qualified options as well as incentive stock options as defined under Section 422 of the Code. The Prior Plan authorized the granting of options or other awards for an aggregate of the greater of 500,000 shares or 9.5% of the diluted outstanding shares of the Company's common stock, up to ceiling of 8,932,921 shares. No further awards will be made under the Prior Plan, although existing awards remain effective.

Stock options were issued at the market price on the date of grant, subject to an immediate or four year vesting in four equal installments with a contractual term of 5 or 10 years. During the year ended December 31, 2011, the Company granted 402,000 restricted shares that vest over four years.

	For the year ended			
	December 31, 2011		December 31, 2010	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Options outstanding at the beginning of year	6,891,975	$15.33	7,271,503	$15.20
Granted	7,500	18.67	8,750	17.24
Exercised	(678,920)	13.19	(363,528)	12.65
Forfeited	-	-	(18,500)	15.21
Expired	(3,750)	12.15	(6,250)	18.26
Options outstanding at the end of period	6,216,805	$15.57	6,891,975	$15.33
Options exercisable at the end of the period	4,451,693	$16.17	3,822,844	$16.16

The weighted average remaining contractual term was approximately 5.5 years for stock options outstanding and approximately 4.8 years for stock options exercisable as of December 31, 2011. As of December 31, 2011, there was approximately $4.2 million of total unrecognized compensation cost related to nonvested share-based compensation awards. That cost is expected to be recognized over a weighted average period of 1.1 years.

The weighted average remaining contractual term was approximately 6.6 years for stock options outstanding and approximately 5.6 years for stock options exercisable as of December 31, 2010. As of December 31, 2010, there was

approximately $8.8 million of total unrecognized compensation cost related to nonvested share-based compensation awards. That cost is expected to be recognized over a weighted average period of 2.0 years.

13. INCOME TAXES

As a REIT, the Company is not subject to federal income tax on earnings distributed to its shareholders. Most states recognize REIT status as well. The Company has decided to distribute the majority of its income and retain a portion of the permanent difference between book and taxable income arising from Section 162(m) of the Code pertaining to employee remuneration.

During the year ended December 31, 2011, the Company's taxable REIT subsidiaries recorded $14.9 million of income tax expense for income attributable to those subsidiaries, and the portion of earnings retained based on Code Section 162(m) limitations. During the year ended December 31, 2011, the Company recorded $44.1 million of income tax expense for a portion of earnings retained based on Section 162(m) limitations.

During the year ended December 31, 2010, the Company's taxable REIT subsidiaries recorded $6.8 million of income tax expense for income attributable to those subsidiaries, and the portion of earnings retained based on Code Section 162(m) limitations. During the year ended December 31, 2010, the Company recorded $28.6 million of income tax expense for a portion of earnings retained based on Section 162(m) limitations

During the year ended December 31, 2009, the Company's taxable REIT subsidiaries recorded $9.7 million of income tax expense for income attributable to those subsidiaries, and the portion of earnings retained based on Code Section 162(m) limitations. During the year ended December 31, 2009, the Company recorded $24.7 million of income tax expense for a portion of earnings retained based on Section 162(m) limitations.

The Company's effective tax rate was 52%, 53%, and 52%, for the years ended December 31, 2011, 2010, and 2009, respectively. These rates were calculated based on the Companies estimated taxable income after dividends paid deduction and differ from the federal statutory rate as a result of state and local taxes and permanent difference pertaining to employee remuneration as discussed above.

The statutory combined federal, state, and city corporate tax rate is 45%. This amount is applied to the amount of estimated REIT taxable income retained (if any, and only up to 10% of ordinary income as all capital gain income is distributed) and to taxable income earned at the taxable subsidiaries. Thus, as a REIT, the Company's effective tax rate is significantly less as it is allowed to deduct dividend distributions.

The Company's 2008, 2009 and 2010 federal and state tax returns remain open for examination.

14. LEASE COMMITMENTS AND CONTINGENCIES

Commitments

The Company has a non-cancelable lease for office space which commenced in May 2002 and expires in December 2015. Merganser has a non-cancelable lease for office space, which commenced on May 2003 and expires in May 2014. Merganser subleases a portion of its leased space to a subtenant. FIDAC has a lease for office space which commenced in October 2010 and expires in February 2016. The Company's aggregate future minimum lease payments total $8.6 million. The following table details the lease payments.

Year Ending December	Lease Commitment	Sublease Income	Net Amount
		(dollars in thousands)	
2012	$ 3,003	$ 70	$ 2,933

2013	3,004	-	3,004
2014	2,522	-	2,522
2015	161	-	161
2016	27	-	27
Later years	-	-	-
	$ 8,717	$ 70	$ 8,647

Contingencies

From time to time, the Company is involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material effect on the Company's consolidated financial statements and therefore no accrual is required as of December 31, 2011 and 2010.

15. RELATED PARTY TRANSACTIONS

For the years ended December 31, 2011 and 2010 the Company recorded advisory fees from Chimera and CreXus totaling $62.8 million and $42.5 million, respectively At December 31, 2011 and 2010, the Company had amounts receivable from Chimera and CreXus of $16.3 million and $13.0 million, respectively

16. INTEREST RATE RISK

The primary market risk to the Company is interest rate risk. Interest rates are highly sensitive to many factors, including governmental monetary and tax policies, domestic and international economic and political considerations and other factors beyond the Company's control. Changes in the general level of interest rates can affect net interest income, which is the difference between the interest income earned on interest-earning assets and the interest expense incurred in connection with the interest-bearing liabilities, by affecting the spread between the interest-earning assets and interest-bearing liabilities. Changes in the level of interest rates also can affect the value of the Interest Earning Assets and the Company's ability to realize gains from the sale of these assets. A decline in the value of the Interest Earning Assets pledged as collateral for borrowings under repurchase agreements could result in the counterparties demanding additional collateral pledges or liquidation of some of the existing collateral to reduce borrowing levels.

The Company seeks to manage the extent to which net income changes as a function of changes in interest rates by matching adjustable-rate assets with variable-rate borrowings. The Company may seek to mitigate the potential impact on net income of periodic and lifetime coupon adjustment restrictions in the portfolio of Interest Earning Assets by entering into interest rate agreements such as interest rate caps and interest rate swaps. As of December 31, 2011 and 2010, the Company entered into interest rate swaps to pay a fixed rate and receive a floating rate of interest, with a total notional amount of $40.1 billion and $27.1 billion, respectively.

Changes in interest rates may also have an effect on the rate of mortgage principal prepayments and, as a result, prepayments on Agency mortgage-backed securities. The Company will seek to mitigate the effect of changes in the mortgage principal repayment rate by balancing assets purchased at a premium with assets purchased at a discount. To date, the aggregate premium exceeds the aggregate discount on the Agency mortgage-backed securities. As a result, prepayments, which result in the expensing of unamortized premium, will reduce net income compared to what net income would be absent such prepayments.

17. RCAP REGULATORY REQUIREMENTS

RCap is subject to regulations of the securities business that include but are not limited to trade practices, use and safekeeping of funds and securities, capital structure, recordkeeping, and conduct of directors, officers and employees.

As a self clearing, registered broker dealer, RCap is subject to the minimum net capital requirements of the Financial Industry Regulatory Authority ("FINRA"). As of December 31, 2011 RCap had a minimum net capital requirement of $252,681 and would be required to notify FINRA if capital was to fall below the early warning threshold of $303,217. RCap consistently operates with capital significantly in excess of its regulatory capital requirements. RCap's regulatory net capital as defined by SEC Rule 15c3-1, as of December 31, 2011 was $351.2 million with

excess net capital of $351.0 million.

18. SUMMARIZED QUARTERLY RESULTS (UNAUDITED)

The following is a presentation of the quarterly results of operations for the year ended December 31, 2011.

	March 31, 2011	June 30, 2011	September 30, 2011	December 31, 2011
	(dollars in thousands, expect per share amounts)			
Interest income:				
Investments	$837,880	$948,703	$926,558	$ 844,874
U.S. Treasury Securities	4,825	6,497	2,302	1,082
Securities loaned	1,343	1,868	1,942	1,744
Total interest income	844,048	957,068	930,802	847,700
Interest expense:				
Repurchase agreements	102,602	100,164	109,014	114,989
Convertible Senior Notes	6,767	6,900	8,798	12,552
U.S. Treasury Securities sold, not yet purchased	4,986	4,772	2,109	1,214
Securities borrowed	1,101	1,484	1,496	1,378
Total interest expense	115,456	113,320	121,417	130,133
Net interest income	728,592	843,748	809,385	717,567
Other income (loss):				
Investment advisory and other fee income	17,207	20,710	20,828	20,460
Net gains (losses) on sales of Agency mortgage-backed securities and debentures	27,185	7,336	91,668	80,657
Dividend income from affiliates	6,297	8,230	8,706	8,283
Net gains (losses) on trading assets	18,812	(5,712)	1,942	6,356
Net unrealized gains (losses) on Agency interest-only mortgage-backed securities	-	276	(39,321)	(67,612)
Income (expense) from underwriting	2,904	(77)	2,772	19
Subtotal	72,405	30,763	86,595	48,163
Realized gains (losses) on interest rate swaps(1)	(206,148)	(216,760)	(231,849)	(227,638)
Unrealized gains (losses) on interest rate swaps	169,308	(466,943)	(1,505,333)	(12,139)
Subtotal	(36,840)	(683,703)	(1,737,182)	(239,777)
Total other income (loss)	35,565	(652,940)	(1,650,587)	(191,614)
Expenses:				
Compensation expense	44,530	49,752	57,629	54,340
Other general and administrative expenses	7,297	7,477	7,565	8,754
Total General and administrative expenses	51,827	57,229	65,194	63,094
Income (loss) before income taxes and income from equity method investment in affiliate	712,330	133,579	(906,396)	462,859
Income taxes	(13,575)	(12,762)	(15,417)	(17,297)

Income from equity method investment in affiliate	1,140	-	-	-
Net income (loss)	699,895	120,817	(921,813)	445,562
Dividends on preferred stock	4,267	4,267	4,172	4,148
Net income (loss) available (related) to common shareholders	$695,628	$116,550	$(925,985)	$ 441,414
Net income (loss) available (related) per share to common shareholders:				
Basic	$0.92	$0.14	$(0.98)	$ 0.46
Diluted	$0.89	$0.14	$(0.98)	$ 0.44
Weighted average number of common shares outstanding:				
Basic	752,413,605	822,623,370	948,545,975	970,056,491
Diluted	790,993,841	827,754,731	948,545,975	1,011,495,682
Net income (loss)	$699,895	$120,817	$(921,813)	$ 445,562
Other comprehensive income (loss):				
Unrealized gains (losses) on available-for-sale securities	(142,227)	1,047,639	1,115,325	16,157
Unrealized losses on interest rate swaps	14,298	-	-	-
Reclassification adjustment for net (gains) losses included in net income (loss)	(27,185)	(7,336)	(91,668)	(80,657)
Other comprehensive income (loss)	(155,114)	1,040,303	1,023,657	(64,500)
Comprehensive income (loss)	$544,781	$1,161,120	$101,844	$ 381,062

(1) Interest expense related to the Company's interest rate swaps is recorded in Realized losses on interest rate swaps on the Consolidated Statements of Operations and Comprehensive Income (Loss).

The following is a presentation of the quarterly results of operations for the year ended December 31, 2010.

	March 31, 2010	June 30, 2010	September 30, 2010	December 31, 2010
	(dollars in thousands, expect per share amounts)			
Interest income:				
Investments	$653,935	$642,782	$700,964	$678,626
U.S. Treasury Securities	-	40	751	2,039
Securities loaned	454	860	1,261	1,422
Total interest income	654,389	643,682	702,976	682,087
Interest expense:				
Repurchase agreements	92,089	96,975	105,393	103,514
Convertible Senior Notes	3,195	6,966	7,033	7,034
U.S. Treasury Securities sold, not yet purchased	-	24	459	2,166
Securities borrowed	387	742	1,047	1,201
Total interest expense	95,671	104,707	113,932	113,915
Net interest income	558,718	538,975	589,044	568,172
Other income (loss):				
Investment advisory and service fees	12,546	13,863	15,343	16,321
Net gains (losses) on sales of Agency mortgage backed security and debentures	46,962	39,041	61,986	33,802
Dividend income	7,964	7,330	8,097	7,647
Net gains (losses) on trading assets	-	77	1,082	(3,510)
Income from underwriting	-	500	915	680
Subtotal	67,472	60,811	87,423	54,940
Realized gains (losses) on interest rate swaps(1)	(180,838)	(175,535)	(188,636)	(190,098)
Unrealized gains (losses) on interest rate swaps	(116,732)	(593,038)	(448,253)	839,191
Subtotal	(297,570)	(768,573)	(636,889)	649,093
Total other (loss) income	(230,098)	(707,762)	(549,466)	704,033
Expenses:				
Distribution fees	360	-	-	-
Compensation expense	34,267	35,080	37,419	40,193
General and administrative expenses	5,754	6,460	6,011	6,303
Total expenses	40,381	41,540	43,430	46,496
Income (loss) before income taxes and income from equity method investment in affiliate	288,239	(210,327)	(3,852)	1,225,709
Income taxes	(7,314)	(8,837)	(11,076)	(8,207)
Income (loss) from equity method investment in affiliate	140	935	868	1,002

Net income (loss)	281,065	(218,229)	(14,060)	1,218,504
Dividends on preferred stock	4,625	4,625	4,515	4,268
Net income (loss) available (related) to common shareholders	$276,440	$(222,854)	$(18,575)	$1,214,236
Net income (loss) available (related) per share to common shareholders:				
Basic	$0.50	$(0.40)	$(0.03)	$1.94
Diluted	$0.49	$(0.40)	$(0.03)	$1.84
Weighted average number of common shares outstanding:				
Basic	554,995,092	559,700,836	611,904,518	625,138,510
Diluted	575,859,564	559,700,836	611,904,518	662,476,638
Net income (loss)	$281,065	$(218,229)	$(14,060)	$1,218,504
Other comprehensive income (loss):				
Unrealized gains (losses) on available-for-sale securities	7,416	664,544	(619,080)	(692,663)
Unrealized losses on interest rate swaps	36,081	26,846	18,402	13,570
Reclassification adjustment for net (gains) losses included in net income (loss)	(46,962)	(39,041)	(61,986)	(33,802)
Other comprehensive income (loss)	(3,465)	652,349	(662,664)	(712,895)
Comprehensive income (loss)	$277,600	$434,120	$(676,724)	$505,609

(1) Interest expense related to the Company's interest rate swaps is recorded in Realized losses on interest rate swaps on the Consolidated Statements of Operations and Comprehensive Income (Loss).

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the city of New York, State of New York.

ANNALY CAPITAL MANAGEMENT, INC.

Date: February 28, 2012

By: /s/ Michael A. J. Farrell
Michael A. J. Farrell
Chairman, Chief Executive Officer, and President

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

Signature	Title	Date
/s/ KEVIN P. BRADY Kevin P. Brady	Director	February 28, 2012
/s/ KATHRYN F. FAGAN Kathryn F. Fagan	Chief Financial Officer and Treasurer (principal financial and accounting officer)	February 28, 2012
/s/ MICHAEL A.J. FARRELL Michael A. J. Farrell	Chairman of the Board, Chief Executive Officer, President and Director (principal executive officer)	February 28, 2012
/s/ JONATHAN D. GREEN Jonathan D. Green	Director	February 28, 2012
/s/ MICHAEL E. HAYLON Michael E. Haylon	Director	February 28, 2012
/s/ JOHN A. LAMBIASE John A. Lambiase	Director	February 28, 2012
/s/ E. WAYNE NORDBERG E. Wayne Nordberg	Director	February 28, 2012
/s/ DONNELL A. SEGALAS Donnell A. Segalas	Director	February 28, 2012
/s/ WELLINGTON DENAHAN-NORRIS Wellington Denahan-Norris	Vice Chairman of the Board, Chief Investment Officer, Chief Operating Officer and Director	February 28, 2012

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